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Tax Abuse - Lessons from Abroad

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TAX ABUSE—LESSONS FROM ABROAD

Orly Sulami*

ABSTRACT

How does a government distinguish between tax planning and tax abuse? Most democratic societies agree that citizens have a right to limit their tax liability through tax planning. But governments generally also agree that this right does not extend to tax abuse. Tax abuse substantially reduces government tax revenues and weakens the integrity of our tax system and the efficiency of our economy. Thus, distinguishing between tax planning and tax abuse is critical. In an attempt to identify and counter tax abuse and its detrimental effects, the United States recently enacted an anti-abuse rule in Section 7701(o) of the Internal Revenue Code. Because tax abuse is difficult to legislatively define, Section 7701(o) relies heavily on the judiciary to make the ultimate determination of which transactions are abusive. This article contends that the international experience with similar general anti-avoidance rules indicates that Section 7701(o) will not be a universal cure for tax abuse but can be an effective anti-abuse tool if certain judicial, legislative, and administrative steps are taken. Therefore, it proposes a reform to Section 7701(o) that would counter the textualist trend and other judicial approaches that potentially undermine the statute while simultaneously increasing the statute's fairness and predictability.

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I. INTRODUCTION

CARLOS Sala was fortunate enough to realize over \$60 million in income during the tax year. But with this income came a significant tax liability.¹ Thus, as many taxpayers do, Sala engaged in tax planning to minimize his tax liability.² For Sala, this involved participating in an investment program that promised to generate over a \$60 million tax loss, without Sala incurring any corresponding financial loss.³ Through this investment, Sala completely eliminated his federal income tax liability.⁴ The investment complied with the literal language of the relevant Internal Revenue Code provision and did not involve any illegal means to obtain the tax benefit.⁵ However, Sala should have thought twice about entering into this transaction. The Court of Appeals for the Tenth Circuit deemed this transaction to be abusive.⁶

Recently enacted anti-abuse legislation has given the Commissioner of Internal Revenue a powerful weapon to counteract transactions, like Sala's investment, that obtain inappropriate tax benefits.⁷ Even though a

1. *Sala v. United States*, 613 F.3d 1249, 1250 (10th Cir. 2010).

2. *Id.*

3. *Id.*

4. *Id.*

5. *Id.* at 1253-54.

6. *Id.* at 1255.

7. See Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, § 1409(a), 124 Stat. 1029, 1067 (codified at I.R.C. § 7701(o) (Supp. 2010)). Sala engaged in

taxpayer does not engage in tax evasion and technically complies with the statutory text, the Commissioner may deem the transaction abusive. And if the IRS or the courts determine that a transaction crosses the line from tax planning to tax abuse, taxpayers are now subject to severe penalties of up to 40% on the underpayment of tax attributable to the tax abusive transaction.⁸

Tax abuse⁹ generally exists when a taxpayer obtains tax benefits from a transaction that complies with the statute's literal text but circumvents the statute's intended purpose. Although most democratic societies agree that taxpayers have a right to engage in acceptable tax planning to minimize their tax liability, they also agree that this right does not extend to tax abusive transactions.¹⁰ Tax abuse that is left unchecked acts as a "fiscal and moral termite[]."¹¹ It eats away at government tax revenues, the integrity of our tax systems, and the efficiency of our economies.¹² Thus, despite the difficulties in precisely defining tax abuse, it is critical for governments to find a way to distinguish these abusive transactions from legitimate tax planning.

Many countries, from China to New Zealand, have enacted a statutory general anti-avoidance rule (commonly referred to as a "GAAR") to target tax abuse and differentiate it from acceptable tax planning.¹³ After years of debate, on March 30, 2010, Congress enacted the United States' own version of a GAAR as part of the Health Care and Education Rec-

the transaction prior to the enactment of this legislation. Therefore, Sala's investment was deemed abusive under the common law version of Section 7701(o), referred to as the economic substance doctrine, rather than Section 7701(o). *Sala*, 613 F.3d at 1255.

8. Although Sala was subject to penalties attributable to his understatement of tax, the 40% penalty did not apply to his tax abusive transaction because the legislation imposing this penalty came into effect after Sala entered into the transaction. Health Care and Education Reconciliation Act of 2010 § 1409(b), (c)(1).

9. Tax abuse is often also referred to as abusive tax avoidance transactions, tax abusive transactions, or tax shelters, and these terms are used interchangeably throughout this Article.

10. See, e.g., *Gregory v. Helvering*, 69 F.2d 809, 810 (2d Cir. 1934) ("Any one may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one's taxes."), *aff'd*, 293 U.S. 465 (1935); SOUTH AFRICAN REVENUE SERVICE, DISCUSSION PAPER ON TAX AVOIDANCE AND SECTION 103 OF THE INCOME TAX ACT, 1962 (ACT NO. 58 OF 1962), at 15 (2005) [hereinafter SARS] (noting that this principle "is not to be denied" and that it can be "found in democratic societies throughout the world").

11. See Chris Evans, *Containing Tax Avoidance: Anti-Avoidance Strategies 3* (Univ. of N.S.W. Faculty of Law Research Series, Working Paper No. 40, 2008).

12. SARS, *supra* note 10, at 9–15. See also Joseph Bankman, *The Economic Substance Doctrine*, 74 S. CAL. L. REV. 5, 22 (2000) (explaining the lost tax revenue and intangible costs of tax shelters); Evans, *supra* note 11, at 3 (describing how abusive tax avoidance transactions have caused tax revenues to diminish across the world); Laura J. Kreissl & Karyn B. Friske, *IRS Scores Recent Judicial Successes Against Tax Shelters*, 81 PRAC. TAX STRATEGIES 338, 338 (2008) (stating that it is estimated that offshore tax abuses cost American taxpayers \$100 billion a year).

13. Many developed countries have a statutory GAAR, including Australia, Canada, China, Germany, Hong Kong, Italy, Ireland, Malaysia, New Zealand, Singapore, Spain, South Africa, and Sweden. Additionally, India has a proposed GAAR, which became effective in April 2012. The Direct Taxes Code Bill, 2010, No. 110, Acts of Parliament, 2010 (India).

conciliation Act of 2010.¹⁴ This law codifies the economic substance doctrine in Section 7701(o) of the Internal Revenue Code of 1986.¹⁵ The economic substance doctrine is an anti-avoidance rule created by the courts to disallow tax benefits otherwise permitted under a literal reading of the tax provisions. Pursuant to Section 7701(o), the Commissioner may invalidate the tax benefits arising from an arrangement that lacks a meaningful economic effect or a substantial non-tax purpose.¹⁶

The enactment of this GAAR-like statute will undoubtedly intensify an already heated debate over the proper role of a general anti-avoidance rule in the United States' fight against tax abuse. Prior to codification of the economic substance doctrine, substantial scholarship was written on the benefits and drawbacks of enacting a GAAR in the United States.¹⁷ Current debates about the new law tend to focus on the changes, or lack thereof, brought by Section 7701(o), as well as the merits of alternative anti-abuse measures.¹⁸ However, most of the scholarship has neither

14. Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, § 1409(a), 124 Stat. 1029, 1067. While Section 7701 is not technically a GAAR, its purpose and operation is quite similar to that of a GAAR. See *infra* Part III.B.

15. Health Care and Education Reconciliation Act of 2010 § 1409(a).

16. I.R.C. § 7701(o)(1) (Supp. 2010). The statute also provides that a state or local income tax effect, which is related to a federal income tax effect, will be treated in the same manner as a federal income tax effect. *Id.* § 7701(o)(3). Individuals engaging in personal transactions are exempt from Section 7701(o). An individual is only subject to the statute's provisions if that individual entered into a transaction in connection with a trade or business or an activity engaged in for the production of income. *Id.* § 7701(o)(5)(B).

17. See, e.g., Graeme S. Cooper, *International Experience with General Anti-Avoidance Rules*, 54 SMU L. REV. 83 (2001) (arguing that the international experience with GAARs shows that a GAAR can play a useful role in countering tax avoidance although it does not completely solve the tax abuse problem); Jerome B. Libin, *Congress Should Address Tax Avoidance Head-On: The Internal Revenue Code Needs a GAAR*, 30 VA. TAX REV. 339 (2010) (discussing how the United States needs to confront tax avoidance directly through the use of a general anti-abuse rule); Martin J. McMahon, Jr., *Beyond a GAAR: Retrofitting the Code to Rein in 21st Century Tax Shelters*, 98 TAX NOTES 1721 (2003) (supporting proposals to codify the economic substance doctrine and defending such proposals from criticisms); Aviv Pichhadze & Amir Pichhadze, *Economic Substance Doctrine: Time for a Legislative Response*, 48 TAX NOTES INT'L 61 (2007) (contending that Congress should enact anti-abuse legislation in the United States because the judicial trend undermines judicial anti-abuse rules); Samuel C. Thompson, Jr. & Robert A. Clary II, *Coming in from the 'Cold': The Case for ESD Codification*, 99 TAX NOTES 1270 (2003) (explaining how codifying the economic substance doctrine in the United States would give the IRS a more effective tool for fighting against tax abuse); Dennis J. Ventry Jr., *Save the Economic Substance Doctrine from Congress*, 118 TAX NOTES 1405 (2008) (discussing why a judicial anti-abuse rule is preferable to a statutory one in the United States and arguing that codification of the economic substance doctrine is a terrible idea).

18. See, e.g., Richard M. Lipton, *'Codification' of the Economic Substance Doctrine—Much Ado About Nothing?*, 112 J. TAX'N 324 (2010) (explaining how most traditional tax planning will not be affected by the addition of Section 7701(o) to the Internal Revenue Code); Allen D. Madison, *Rationalizing Tax Law by Breaking the Addiction to Economic Substance*, 47 IDAHO L. REV. 441 (2011) (critiquing the economic substance doctrine and recommending a risk requirement as an alternative to the economic substance doctrine); Bret Wells, *Economic Substance Doctrine: How Codification Changes Decided Cases*, 10 FLA. TAX REV. 411 (2010) (analyzing several historical court decisions in light of Section 7701(o) to illustrate how tax jurisprudence may be impacted as a result of the new law); Martin J. McMahon Jr., *Living with (and Dying by) the Codified Economic Substance Doctrine* (Univ. of Fla. Levin Coll. of Law, Research Paper No. 2010-13, 2010) (discussing the minimal changes made by the new law other than with respect to the penalty provisions).

evaluated whether the newly enacted legislation will operate successfully in the United States nor considered how to improve the statute that has been enacted. This Article fills a gap in the literature by identifying and examining Section 7701(o) and the judicial approaches historically taken in the United States to predict whether Section 7701(o) will serve as an effective anti-abuse measure. This Article contends that although Section 7701(o) is not a universal cure for tax abuse, it can be used to successfully identify and counter abusive tax schemes if certain congressional steps are taken. This Article makes several points to support this argument.

First, this Article explains how Section 7701(o) is comparable to a GAAR. Specifically, Section 7701(o), like other GAARs, is a statutory provision targeted at preventing general tax avoidance. Its purpose and operation are both considerably similar to that of a GAAR in other common law countries.¹⁹

Second, this Article illustrates how the international experience with a GAAR provides a number of lessons for the U.S. debate.²⁰ Specifically, the tax avoidance jurisprudence in Canada, Australia, and New Zealand provides meaningful insight into judicial approaches that can undermine, as well as strengthen, our newly enacted Section 7701(o).²¹ These countries, like the United States, are common law jurisdictions that have GAARs with similar features to Section 7701(o). Canada's proximity to the United States, its role as our largest trading partner, and its similar laws and culture make the lessons that emerge from the Canadian experience with a GAAR particularly relevant to the new U.S. law. Moreover, Australia's and New Zealand's long experiences with GAARs shed light on judicial approaches that cause tax abuse to flourish, as well as approaches that cause tax abuse to diminish.

The international experience also reveals that judiciaries that support the *Duke of Westminster* principle generally adopt judicial approaches that undermine a GAAR's effectiveness. The *Duke of Westminster* principle emphasizes a taxpayer's right to arrange his or her affairs in any manner that complies with a statute's literal requirements.²² Accordingly, courts endorsing this principle employ a literalist interpretation of statutes and often refuse to consider a lack of economic substance, as well as other indicia of tax avoidance, as relevant factors in the tax abuse analysis. In addition, these courts may place an unreasonably high burden of proof on the government in tax abuse cases to protect a taxpayer's right to engage in tax planning. This often results in the GAAR applying to counteract abusive tax avoidance transactions in obvious cases, but not applying when the legislative intent with respect to a specific provision is

19. See *infra* Part III.B.; John Prebble, *Prebble Welcomes the US Treasury and IRS to the Ranks of GAAR-Empowered Fiscs*, TAX PROF BLOG (2010), <http://taxprof.typepad.com/files/prebble.pdf>.

20. See *infra* Part IV.

21. Although the British experience with a particular law generally provides helpful insight into a new U.S. law, the United Kingdom does not currently have a GAAR.

22. See *Inland Revenue Comm'r v. Duke of Westminster*, [1936] A.C. 1 (H.L.) (U.K.).

not as clear.²³ On the other hand, tax abusive transactions are more likely caught within the scope of a GAAR when courts purposively interpret statutes, consider economic substance and other factors in their tax abuse analysis, place reasonable burdens of proof on the parties, and disaggregate abusive transactions from legitimate arrangements.²⁴

Third, this Article demonstrates that while Congress may need to amend Section 7701(o) in the future, Section 7701(o) can be an effective weapon against tax abuse in the United States.²⁵ American courts have adopted many of the judicial approaches in the tax abuse context that have strengthened GAARs abroad. Specifically, U.S. courts reject the *Duke of Westminster* principle, consider economic substance and other tax avoidance indicia as relevant to the tax abuse analysis, do not place an oppressive burden on the government to prove tax abuse, and separately consider tax abusive transactions even when they are hidden in acceptable business arrangements.

However, the United States has also taken several approaches that potentially undermine Section 7701(o)'s effectiveness. Specifically, U.S. courts have increasingly used a textualist method of statutory interpretation in tax abuse cases and emphasize a taxpayer's subjective motives in entering into the arrangement. The Canadian, Australian, and New Zealand experiences illustrate that these approaches often emasculate a GAAR. Thus, this Article suggests legislative and administrative responses that can be taken to ensure the success of Section 7701(o). This Article proposes that Congress should amend Section 7701(o) to explicitly require courts to consider congressional intent in their tax abuse analysis, as well as to require courts to consider objective, rather than subjective, evidence of the arrangement's purpose. These changes would make Section 7701(o) a more effective anti-abuse measure and also increase the statute's fairness and predictability.

The remainder of this Article expands upon these arguments. Following this Introduction, Part II explores the difficulty in distinguishing tax abuse from acceptable tax planning and will demonstrate that some form of general anti-avoidance rule is necessary to identify and counteract tax abuse. Part III explains that the addition of Section 7701(o) to the Internal Revenue Code represents the introduction of a statutory GAAR in the United States. It describes the similarities between the statutory provisions of Section 7701(o) and the GAARs currently in force in Canada, Australia, and New Zealand. Part IV analyzes the implications of the tax avoidance jurisprudence in Canada, Australia, and New Zealand on the effectiveness of each country's GAAR as an anti-avoidance measure. This Article argues that courts that fail to (i) purposively interpret stat-

23. See *infra* Part IV; Brian Arnold, *The Canadian Experience with a General Anti-Avoidance Rule*, in BEYOND BOUNDARIES: DEVELOPING APPROACHES TO TAX AVOIDANCE AND TAX RISK MANAGEMENT 29, 32 (Judith Freedman ed., 2008); Susan Van Der Hout, *Good News for Taxpayers on Canadian GAAR*, 15 J. INT'L TAX'N 44, 46 (2004).

24. See *infra* Part IV.

25. See *infra* Part V.

utes, (ii) consider economic substance and other objective factors as part of the tax abuse analysis, (iii) disaggregate abusive steps from the overall business arrangement, and (iv) place a reasonable burden of proof on the parties undermine a GAAR's effectiveness, while courts that adopt these approaches often strengthen a GAAR. Part V contends that Section 7701(o) will likely prove to be an effective weapon in the United States against tax abuse, but that Congress may need to amend Section 7701(o) in the future to ensure its success.

II. WHAT IS TAX ABUSE?

A fundamental difficulty governments face is how to distinguish between legitimate tax planning and tax abuse.²⁶ A significant reason for this difficulty is that tax abusive transactions are both situational and dynamic, which makes them difficult to precisely define.²⁷ But making this distinction between legitimate tax planning and abusive tax avoidance is critical.

Numerous studies have identified significant tangible and intangible costs that tax shelters cause.²⁸ These studies emphasize that tax abuse is detrimental to the operation of governments because it reduces a government's revenue collections and consequently weakens the government's ability to set and implement national economic policy.²⁹ Additionally, transactions that claim inappropriate tax benefits breed disrespect for the tax system and the law, which increases non-compliance.³⁰ Tax abusive transactions also unfairly shift the tax burden, distort economic behavior by diverting resources from more productive ventures, and result in increasingly complex laws as the government struggles to counteract specific abusive transactions.³¹ Given these detrimental consequences, most commentators agree that even though there is no universal definition of "tax abuse," it is a persistent problem that needs to be addressed.³² In an

26. Leandra Lederman, *W(h)ither Economic Substance?*, 95 IOWA L. REV. 389, 394–95 (2010) (explaining that it is difficult to identify the line between acceptable tax planning and tax abuse, because different tax statutes have different goals: the goal of some tax statutes is to measure income, while the goal of other tax statutes is to induce a desired behavior).

27. Evans, *supra* note 11, at 5; Madison, *supra* note 18, at 464; Eugen Trombitas, *The Conceptual Approach to Tax Avoidance in the 21st Century: When the Statute Gives but the GAAR Can Take Away*, 15 N.Z. J. TAX'N L. & POL'Y 352, 353 (2009).

28. See, e.g., SARS, *supra* note 10, at 9–15 (describing the detrimental effects of abusive tax avoidance transactions in a study conducted by the South African Revenue Service); DEP'T OF THE TREASURY, THE PROBLEM OF CORPORATE TAX SHELTERS: DISCUSSION, ANALYSIS AND LEGISLATIVE PROPOSALS (1999); Kreissl & Friske, *supra* note 12, at 338 (stating that it is "estimated that offshore tax abuses cost American taxpayers \$100 billion a year").

29. SARS, *supra* note 10, at 9–15.

30. *Id.* at 10.

31. *Id.* at 11–15.

32. See, e.g., Lederman, *supra* note 26, at 391–92 (stating that tax abuse is a perennial problem that needs to be solved and suggesting that courts can help counteract such transactions by considering whether the claimed tax benefit is consistent with the intent of the applicable provisions); Charlene Luke, *What Would Henry Simons Do?: Using an Ideal to*

attempt to identify and counter such tax abuses, countries worldwide have enacted specific and general anti-abuse legislation.

A. THE DIFFICULTY OF DEFINING TAX ABUSE

Tax abuse, like tax evasion, is a method taxpayers use to minimize or eliminate their tax liability. Despite similar tax-minimization goals, abusive tax avoidance transactions are easily distinguishable from tax evasion. Tax evasion involves the deliberate breach of the tax law through fraud, concealment, or other illegal measures so that a taxpayer can avoid paying its true tax liability.³³ Most nations view tax evasion as a serious offense and have enacted laws that clearly define and prohibit tax evasion activities.

On the other hand, tax abuse does not involve the use of illegal measures to create tax benefits. Instead, tax abuse generally exists when a taxpayer reduces its tax liability by ordering its affairs in a manner that complies with the text of the statute but contradicts the intent of the law it purports to follow.³⁴ Taxpayers engaging in tax abusive transactions often lower their tax liability by manipulating “inconsistencies” and “discontinuities” inherent in national tax systems and across international borders.³⁵ Abusive tax schemes take advantage of gaps in the tax system, exploit or abuse tax relief provisions, create tax advantages through off-shore schemes, and use statutory provisions designed to prevent tax avoidance in a manner that generates tax benefits, often at the expense of the government.³⁶

Despite this broad definition, tax abuse is fact-specific and difficult to precisely define.³⁷ Moreover, most democratic societies recognize a taxpayer's right to engage in tax planning to minimize his or her tax liability within the bounds of the law.³⁸ Thus, governments often struggle with

Shape and Explain the Economic Substance Doctrine, 11 Hous. Bus. & Tax L.J. 108, 109 (2011) (stating that there is not yet any consensus on which transactions should be labeled as tax shelters). A significant amount of scholarship exists on how to effectively counteract tax abuse, which further highlights scholars' consensus that tax abuse needs to be adequately minimized. See, e.g., Marvin A. Chirelstein & Lawrence A. Zelenak, *Tax Shelters and the Search for a Silver Bullet*, 105 COLUM. L. REV. 1939, 1955 (2005) (proposing a statutory solution to the tax-shelter problem, which is based on a general disallowance of non-economic losses); Libin, *supra* note 17, at 351 (arguing that the United States needs to confront tax avoidance directly through legislative changes to prevent taxpayers from reducing their federal income tax burden inappropriately).

33. SARS, *supra* note 10, at 2–3. Common examples of tax evasion include the deliberate failure to file a tax return or to report all taxable income, the deliberate claim of a deduction for a non-existent expense, or concealing or falsifying other relevant information. *Id.* at 3.

34. Evans, *supra* note 11, at 4.

35. *Id.* at 6–7.

36. *Id.* at 7–8.

37. *Id.* at 9; Trombitas, *supra* note 27, at 353.

38. See, e.g., *Gregory v. Helvering*, 69 F.2d 809, 810 (2d Cir. 1934) (“Any one may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one's taxes.”), *aff'd*, 293 U.S. 465 (1935); SARS, *supra* note 10, at 15 (noting this principle is not to be denied and is a principle found in democratic societies throughout the world).

the tension between permitting taxpayers to engage in legitimate tax-minimizing activities and protecting the tax system from abuse.³⁹ This tension has caused the line delineating tax abuse from acceptable tax planning to be an unclear and moving target.⁴⁰

B. THE HALLMARKS OF TAX ABUSE

Even though tax abuse may be difficult to precisely define, these transactions often share common attributes.⁴¹ One key feature that many abusive tax avoidance schemes exhibit is a lack of economic substance.⁴² While a “real” transaction has as its origin and purpose to make money by increasing profits with the return on investment related to the risk involved, abusive tax avoidance schemes characteristically have little or no business, commercial, or non-tax drivers.⁴³ Additionally, taxpayers engaged in abusive tax avoidance schemes often have little or no economic risk.⁴⁴ Accordingly, these transactions also offer little or no opportunity for pre-tax gain.⁴⁵

So why would a rational investor enter into a transaction that has very little, if any, potential for profit? The answer is in the tax benefits that abusive tax avoidance transactions offer. Instead of offering pre-tax gains, abusive tax avoidance transactions offer “returns” on the investment in the form of tax benefits.⁴⁶ These tax benefits create an attractive after-tax profit, which makes these transactions profitable for many investors.⁴⁷

Taxpayers often also benefit on their financial statements from abusive tax avoidance arrangements.⁴⁸ These transactions regularly create a mismatch between the legal form or accounting treatment of the transaction and its economic substance.⁴⁹ This mismatch often results in an inconsistent treatment for tax and financial accounting purposes, which is gener-

39. Chris Evans, *Barriers to Avoidance: Recent Legislative and Judicial Developments in Common Law Jurisdictions*, 37 H.K. L.J. 103, 106–07 (2007).

40. *Id.* at 106 (stating the boundary line between tax abuse and tax planning “will inevitably change in the light of ever-changing social, legal and economic circumstances”).

41. SARS, *supra* note 10, at 19 (noting a growing recognition that many of the most abusive tax avoidance schemes share common characteristics); Evans, *supra* note 11, at 15 (describing similar indicia of tax avoidance created by the Anti-Avoidance Group of Her Majesty’s Revenues and Customs in the United Kingdom). Various schemes may have some, but not all, of these badges of tax avoidance. SARS, *supra* note 10, at 19.

42. SARS, *supra* note 10, at 20; STAFF OF THE JOINT COMM. ON TAXATION, JCX-18-10, TECHNICAL EXPLANATION OF THE REVENUE PROVISIONS OF THE “RECONCILIATION ACT OF 2010,” AS AMENDED, IN COMBINATION WITH THE “PATIENT PROTECTION AND AFFORDABLE CARE ACT” 142–43 (2010).

43. SARS, *supra* note 10, at 20; Peter C. Canellos, *A Tax Practitioner’s Perspective on Substance, Form and Business Purpose in Structuring Business Transactions and in Tax Shelters*, 54 SMU L. REV. 47, 52 (2001); Evans, *supra* note 11, at 8.

44. SARS, *supra* note 10, at 20.

45. *Id.*

46. *Id.* Therefore, a significant investment often appears illusory and the taxpayer remains insulated from nearly all of the economic risk. *Id.*

47. *Id.*

48. *Id.* at 23.

49. *Id.*

ally to the taxpayer's advantage.⁵⁰ In addition, tax shelters often also include involvement by taxpayers outside of their normal areas of expertise, the use of new, complex financial instruments, or the use of tax haven arrangements.⁵¹

Many tax abusive schemes are complex transactions with high transaction costs.⁵² To generate the desired result and to disguise the true nature of the scheme, these transactions often require numerous contrived, artificial, preordained, or economically unnecessary steps.⁵³ Abusive tax avoidance transactions may also involve the use of tax-indifferent parties or special purpose entities to achieve the desired tax benefit, which further increases the transaction's complexity and costs.⁵⁴

C. THE ATTEMPT TO LEGISLATIVELY DEFINE TAX ABUSE

Despite the common indicia of tax abuse, defining tax abuse ultimately depends on the particular facts and circumstances involved.⁵⁵ In an attempt to define and minimize tax abuse, governments often enact specific anti-avoidance rules. Unfortunately, specific anti-avoidance rules cannot legislatively define the almost infinite tax abusive transactions that may arise.

Specific anti-avoidance rules are narrowly drafted tax provisions that target particular areas where abuse has been identified.⁵⁶ These rules legislatively define tax abuse by specifying particular transactions that are prohibited or certain conditions that must be met for a transaction to be respected.⁵⁷ Most taxpayers and tax practitioners who engage in tax planning have come across these rules. For instance, specific anti-avoidance rules that commonly apply in the international tax planning context include the controlled foreign company rules, transfer pricing rules, and thin capitalization rules.

Even though specific anti-avoidance rules have the advantage of precision and offer taxpayers predictability, specific anti-avoidance measures alone can never solve the tax abuse problem.⁵⁸ It is not feasible, as well as highly inefficient, for legislatures to enact specific rules to target all

50. *Id.*

51. *Id.* at 25–27.

52. *Id.* at 24.

53. *Id.* at 21–22; Evans, *supra* note 11, at 10; *Comm'r of Inland Revenue v Penny* [2010] 3 NZLR 360, para [110] (CA) (N.Z.), *aff'd*, [2012] 1 NZLR 433 (SC).

54. For instance, tax shelters often utilize foreign persons, partnerships, pension funds, and taxpayers that can generate offsetting deductions, such as net operating losses. SARS, *supra* note 10, at 21. Fees are not only paid to these tax-indifferent parties, but are often also paid to the scheme promoters, which further increases the transaction's costs. *See id.* at 24.

55. Evans, *supra* note 11, at 9.

56. *Id.* at 21. For example, the United Kingdom has been “among the more prolific of the common law jurisdictions in introducing new specific anti-avoidance measures in recent years.” *Id.* at 23. The United States' complex Code is also filled with countless specific rules targeted at preventing certain tax abuses.

57. *Id.* at 21–22.

58. SARS, *supra* note 10, at 47.

forms of tax abusive activities.⁵⁹ Because a government generally enacts specific anti-avoidance rules only after it identifies a new tax scheme, specific anti-abuse rules tend to be reactive in nature.⁶⁰ Thus, many taxpayers are able to benefit from the particular scheme during the time it takes the government to identify and enact rules to target that scheme.⁶¹ Moreover, these rules often become ineffective with time as taxpayers devise new schemes to circumvent the specific anti-avoidance rules or to use the rules to their advantage.⁶² Specific anti-abuse rules, which are detailed provisions, also add complexity to already complex tax systems.⁶³

Because of the deficiencies inherent in specific anti-abuse rules, some discretion must be left to the judges in making the ultimate determination of which transactions are tax abusive. This is often achieved through the enactment of a GAAR. A GAAR is a statutory general anti-avoidance rule that broadly defines tax abuse but leaves the ultimate determination of tax abuse to the courts.

The enactment of a GAAR reflects the basic recognition that even the best drafted tax legislation cannot foresee every future situation that may develop or every scheme that may be created in response to it.⁶⁴ A GAAR seeks to protect the income tax liability established under other provisions of the tax legislation by generally prohibiting transactions that claim a tax benefit in an abusive manner.⁶⁵ The broad anti-abuse focus of this measure helps avoid the endless reactionary cycle produced by specific tax measures.⁶⁶ The broad nature of modern GAARs also inherently provides the judiciary with significant discretion in applying and interpreting the GAAR.⁶⁷ Thus, the ultimate meaning of tax abuse depends significantly on how courts interpret and apply a GAAR in their decisions.

III. ELEMENTS OF A GAAR IN THE UNITED STATES AND ABROAD

A GAAR is not a new phenomenon. Australia and New Zealand have long histories of GAARs, which have served as the framework for the GAARs of other countries.⁶⁸ In 1985, the Canadian Parliament enacted

59. *See id.* (observing that specific anti-avoidance rules are insufficient to fight tax avoidance alone because of the inherent “discontinuities” that exist in any tax system, together with an almost endless supply of new financial instruments).

60. *See* DEP’T OF THE TREASURY, *supra* note 28, at xiii.

61. *See id.*

62. *See* SARS, *supra* note 10, at 6–7, 25.

63. *Id.* at 11.

64. *Id.* at 6–7.

65. *Id.* at 6.

66. *See* Cooper, *supra* note 17, at 128 (proposing that a GAAR may effectively counteract self-generated tax ploys and aggressively marketed externally developed schemes sold to taxpayers).

67. Karen Burke, *Reforming Economic Substance*, 31 VA. TAX REV. 271, 273 (2011).

68. *See Ben Nevis Forestry Ventures Ltd. v Comm’r of Inland Revenue* [2009] 2 NZLR 289 (SC) paras [11, 83] (N.Z.) (describing the extensive history of the New Zealand

a GAAR.⁶⁹ Numerous other countries have also used a statutory GAAR as an anti-abuse tool for years, and the number of common law jurisdictions without a GAAR is rapidly decreasing.⁷⁰

Until recently, the United States did not have any statute that was comparable to a GAAR. But after decades of debate on whether the United States should enact a GAAR, on March 30, 2010, Congress enacted a similar provision in Section 7701(o) of the Internal Revenue Code.⁷¹

Section 7701(o) is the codified version of the economic substance doctrine—a long-standing judicial doctrine. In essence, it is a broadly worded statute that prohibits taxpayers from benefitting from transactions that lack either a meaningful economic effect or a substantial non-tax purpose.⁷² While Section 7701(o) is not technically a GAAR, it has prominent GAAR-like characteristics and will likely operate much like the GAARs in other common law jurisdictions, such as Canada, Australia, and New Zealand.⁷³

A. THE PROVISIONS OF A MODERN GAAR

The currently operative GAARs in Canada, Australia, and New Zealand are representative of the modern GAARs in many common law jurisdictions. These GAARs, like other modern GAARs, have three common design elements. First, each GAAR defines a tax avoidance arrangement.⁷⁴ This definition identifies the prerequisites for applying the GAAR to a transaction and generally depends on the application of broad factors. Second, each GAAR defines a tax benefit.⁷⁵ Finally, each GAAR contains powers of reconstruction. These powers permit the applicable revenue authority to reverse the tax outcome of the tax avoidance arrangement, substitute one of the possible tax outcomes that might have otherwise occurred or both.⁷⁶

GAAR); SARS, *supra* note 10, at 27, 32 (describing the history of the Australian GAAR); see also Irving Aw, *Revisiting the General Anti-Avoidance Rule in Singapore*, 2009 SING. J. LEGAL STUD. 545, 547 (2009) (describing how Singapore's GAAR is based substantially on the anti-tax avoidance provisions of Australia and New Zealand).

69. Income Tax Act, R.S.C. 1985, c. 1, Part XVI (Can.).

70. Many developed countries have a statutory GAAR including Australia, Canada, China, Germany, Hong Kong, Italy, Ireland, Malaysia, New Zealand, Singapore, Spain, South Africa, and Sweden. DEP'T OF THE TREASURY, *supra* note 28, at 119–29; Cooper, *supra* note 17, at 84; McMahon, *supra* note 17, at 1723. In recent years, the United Kingdom and India have been prominent examples of countries without a GAAR. However, India has a proposed GAAR, which became effective in April 2012. And the United Kingdom has recently considered the merits of enacting a GAAR. Cooper, *supra* note 17, at 84.

71. Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, § 1409(a), 124 Stat. 1029, 1067. For examples of the differing views on whether or not the United States should enact some form of a GAAR, see *supra* note 17 and accompanying text.

72. I.R.C. § 7701(o) (Supp. 2010).

73. See Evans, *supra* note 11, at 24; Prebble, *supra* note 19, at 2–3.

74. Cooper, *supra* note 17, at 98–99.

75. *Id.* at 102.

76. *Id.* at 103–04.

1. Canadian GAAR Provisions

The Canadian GAAR⁷⁷ includes the common design elements of a GAAR. It broadly defines an “avoidance transaction” as a transaction that directly or indirectly results in a tax benefit, either by itself or as part of a series of transactions, unless the transaction was undertaken primarily for bona fide non-tax purposes.⁷⁸ In addition, it provides that an avoidance transaction constitutes tax abuse, to which the Canadian GAAR applies, if the avoidance transaction can “reasonably be considered” to directly or indirectly result in (a) a misuse of the provisions of the Canadian Income Tax Act, Income Tax Regulations, Income Tax Application Rules, other tax statutes, or a tax treaty or (b) abuse having regard to those provisions read as a whole.⁷⁹ Transactions that are tax driven, but within the object, spirit, and purpose of the relevant provisions, do not abuse or misuse the statute.⁸⁰

The Canadian GAAR also defines a “tax benefit” to include most alterations to a taxpayer’s tax liability. Finally, the Canadian GAAR provides the Commissioner with broad powers to reconstruct the tax consequences in the event the Canadian GAAR applies.⁸¹

2. Australian GAAR Provisions

The Australian GAAR has been subject to several amendments. Prior to 1981, the operative Australian GAAR (referred to herein as “Section 260”) was a short and broadly worded provision that was substantially similar to the current New Zealand GAAR.⁸² Despite Section 260’s broad language, a series of judicial decisions narrowly construed Section 260 and rendered it inadequate in combating even the most blatant tax

77. Income Tax Act, R.S.C. 1985, c. 1, Part XVI (Can.). The Canadian GAAR became effective in 1988 and was amended retroactively in 2005 to explicitly include Canada’s tax treaties within the scope of the rule.

78. *Id.* § 245(3).

79. *Id.* § 245(4).

80. The Supreme Court of Canada has interpreted the “misuse or abuse” requirement to involve a two-step process. The first step is to interpret the provisions giving rise to the tax benefit to determine their object, spirit, and purpose. This requires the court to engage in a textual, contextual, and purposive analysis to determine Parliament’s intention in enacting the relevant provisions. The second task is to determine whether the transaction falls within or frustrates that purpose. *R. v. Can. Trustco Mortg. Co.*, [2005] 2 S.C.R. 601, paras. 17, 55 (Can.).

This “misuse or abuse” requirement is similar to the purposive interpretation of tax statutes that is required in many countries. Accordingly, the Canadian GAAR, like the New Zealand and Australian GAARs, requires three conditions to be satisfied for the GAAR to apply to an arrangement. First, a tax benefit must arise from the transaction. Second, the transaction’s primary purpose must be to obtain a tax benefit. Finally, the manner in which the tax benefit is obtained must be contrary to the legislature’s intent in enacting the provision that gave rise to the claimed tax benefit. *Id.* para. 17.

81. Income Tax Act § 245, (1), (2), (5).

82. Section 260 provided that any arrangement that has the purpose or effect of directly or indirectly obtaining a tax benefit is void against the Commissioner. This provision was found in Section 260 of the *Income Tax Assessment Act 1936* (Cth).

avoidance.⁸³

To overcome the GAAR's ineffectiveness, the Australian Parliament repealed the GAAR in 1981 and enacted a more detailed and complex GAAR in Part IVA of the Income Tax Assessment Act 1936 (referred to herein as "Part IVA" or the "Australian GAAR").⁸⁴ Part IVA, like other modern GAARs, contains the common design elements of a GAAR. Specifically, the Australian GAAR defines a tax avoidance arrangement or a "scheme to which [Part IVA] applies" as existing when three requirements are met.⁸⁵ First, there must be a "scheme."⁸⁶ Second, the taxpayer must derive a tax benefit from the scheme that would not otherwise have been available to the taxpayer if the parties had not entered into the scheme.⁸⁷ Finally, the scheme must have been entered into for the sole or dominant purpose of obtaining a tax benefit.⁸⁸ But unlike the Canadian or New Zealand GAARs, the statute directs the courts to consider eight statutory factors in determining the taxpayer's purpose in entering into the scheme.⁸⁹ These statutory factors focus on how the scheme is implemented, its effects, and the nature of any connection between or among the parties to the scheme.⁹⁰

In addition, the Australian GAAR broadly defines a tax benefit.⁹¹ Fi-

83. See Lidia Xynas, *Tax Planning, Avoidance and Evasion in Australia 1970-2010: The Regulatory Responses and Taxpayer Compliance*, 20 REVENUE L.J. Issue 1, Article 2 (2010).

84. See Explanatory Memorandum, Income Tax Laws Amendment Bill (No. 2) 1981 (Cth 2) (Austl.) (indicating that through the revised GAAR, the legislature sought to provide an effective general measure against tax avoidance arrangements that are "blatant, artificial or contrived"); David Pickup, *In Relation to General Anti-Avoidance Provisions: A Comparative Study of the Legal Frameworks Used by Different Countries to Protect Their Tax Revenues*, in BEYOND BOUNDARIES: DEVELOPING APPROACHES TO TAX AVOIDANCE AND TAX RISK MANAGEMENT 9, 16 (Judith Freedman ed., 2008).

85. *Income Tax Assessment Act 1936* (Cth) s 177D (Austl.).

86. *Id.* A "scheme" is any agreement, arrangement, understanding, promise, or undertaking, whether express or implied and whether or not enforceable, or intended to be enforceable, by legal proceedings and any scheme, plan, proposal, action, course of action, or course of conduct. It includes a unilateral scheme. *Id.* s 177A(1).

87. *Id.* s 177D. Tax benefits arise from a scheme only if it can be hypothesized that the tax benefit would not have been obtained or might reasonably be expected not to have been obtained if the scheme had not been entered into or carried out. *Id.* s 177C.

88. *Id.* s 177D.

89. *Id.*

90. *Id.* The statute identifies the following eight factors: "(i) the manner in which the scheme was entered into or carried out; (ii) form and substance of the scheme; (iii) the time at which the scheme was entered into and the length of the period during which the scheme was carried out; (iv) the result in relation to the operation of [the Australian Income Tax] Act that, but for [Part IVA], would be achieved by the scheme; (v) any change in financial position of the relevant taxpayer that has resulted, will result, or may reasonably be expected to result, from the scheme; (vi) any change in the financial position of any person who has, or has had, any connection (whether of a business, family or other nature) with the relevant taxpayer, being a change that has resulted, will result or may reasonably be expected to result, from the scheme; (vii) any other consequence for the relevant taxpayer, or for any person referred to in subparagraph (vi), of the scheme having been entered into or carried out; and (viii) the nature of any connection (whether of a business, family or other nature) between the relevant taxpayer and any person referred to in subparagraph (vi)." *Id.*

91. *Id.* s 177C(1).

nally, the Australian GAAR, like other modern GAARs, also contains powers of reconstruction that permit the Commissioner to deny in whole or in part the tax benefit.⁹²

3. *New Zealand GAAR Provisions*

The New Zealand GAAR⁹³ is a short and broadly drafted provision that also contains the typical design elements of a GAAR. It is commonly considered to be one of the oldest GAARs in existence.⁹⁴ The current New Zealand GAAR broadly defines a tax avoidance arrangement as any arrangement,

whether entered into by the person affected by the arrangement or by another person, that directly or indirectly—(a) has tax avoidance as its purpose or effect; or (b) has tax avoidance as 1 of its purposes or effects, whether or not any other purpose or effect is referable to ordinary business or family dealings, if the tax avoidance purpose or effect is not merely incidental.⁹⁵

The New Zealand GAAR also broadly defines a tax benefit, which it refers to as “tax avoidance.”⁹⁶ Pursuant to the New Zealand GAAR, a tax benefit includes, but is not limited to, “directly or indirectly altering the incidence of any income tax.”⁹⁷ Finally, the New Zealand GAAR provides that a tax avoidance arrangement is void against the Commissioner for income tax purposes and authorizes the Commissioner to counteract any “tax advantage” obtained by a person from such an arrangement in a way the Commissioner thinks appropriate.⁹⁸

92. *Id.* s 177F.

93. The currently operative GAAR in New Zealand refers collectively to the following provisions of the New Zealand Income Tax Act 2007: (i) the principle anti-avoidance provision contained in Section BG 1, (ii) the relevant definitions in Section YA 1, and (iii) the reconstruction provisions in Part G (hereinafter collectively referred to as the “New Zealand GAAR”).

94. New Zealand has had a general anti-avoidance provision in tax legislation since 1878. In 1878, this provision was found in Section 62 of the New Zealand Land Tax Act 1878. The Commissioner’s active reliance on it began during the 1960s, at which time the general anti-avoidance provision was contained in Section 108 of the Land and Income Tax Act 1954. Judicial criticism of its terms and their limits led to Parliament substantially amending the general anti-avoidance provision in 1974 and replacing it with Section 99 of the Income Tax Act 1976. The language of the general anti-avoidance provision contained in Section 99 of the Income Tax Act 1976 substantively carried through to subsequent general anti-avoidance provisions and eventually became the current Section BG 1 (and related provisions) of the Income Tax Act 2007. See *Ben Nevis Forestry Ventures Ltd. v Comm’r of Inland Revenue* [2008] NZSC 115 (SC) paras [11, 83] (N.Z.).

95. Income Tax Act, s YA 1 (N.Z.). An “arrangement” means any “agreement, contract, plan, or understanding, whether enforceable or unenforceable, including all steps and transactions by which it is carried into effect.” *Id.*

96. *Id.*

97. *Id.* Tax abuse also includes directly or indirectly relieving, avoiding, postponing, or reducing a person’s liability to income tax or any potential or prospective liability to future income tax. *Id.*

98. *Id.* ss BG1, GA1.

B. THE U.S. VERSION OF A GAAR

As noted above, the United States' GAAR-like statute is found in Section 7701(o) of the Code. Section 7701(o) provides that:

[i]n the case of any transaction to which the economic substance doctrine is relevant, such transaction shall be treated as having economic substance only if—(A) the transaction changes in a meaningful way (apart from Federal income tax effects) the taxpayer's economic position, and (B) the taxpayer has a substantial purpose (apart from Federal income tax effects) for entering into such transaction.⁹⁹

The economic substance doctrine is a judicial doctrine created to invalidate tax benefits from transactions that literally comply with the Internal Revenue Code but lack economic reality.¹⁰⁰ It has served as one of the government's primary weapons to fight tax abuse.¹⁰¹

Despite the unique statutory language, Section 7701(o) is considerably similar to the GAARs in Canada, New Zealand, Australia, and other common law jurisdictions. Like these other GAARs, the purpose of Section 7701(o) is to prevent taxpayers from reaping tax benefits through transactions that subvert the purpose of the tax code. Furthermore, Section 7701(o) also operates similarly to these other GAARs in that it relies heavily on the judiciary to interpret and apply the provision to specific transactions.

Section 7701(o) also contains the elements of a modern GAAR. As the GAARs in Canada, New Zealand, and Australia have done, Section 7701(o) defines a tax avoidance arrangement.¹⁰² Pursuant to Section 7701(o), an abusive tax avoidance arrangement exists when two requirements are met. First, the common law economic substance doctrine must be relevant to the transaction or series of transactions.¹⁰³ Thus, the courts will continue to make this determination.¹⁰⁴ The statute does not provide explicit rules for determining when Section 7701(o) applies, but the legislative history indicates that courts should engage in a purposive analysis of the applicable provisions to make this determination.¹⁰⁵ Sec-

99. I.R.C. § 7701(o)(1) (Supp. 2010). The statute also provides that state or local income tax effect, which is related to a federal income tax effect, will be treated in the same manner as a federal income tax effect. *Id.* § 7701(o)(3).

Individuals engaging in personal transactions are exempt from Section 7701(o). An individual is only subject to the statute's provisions if that individual entered into a transaction in connection with a trade or business or an activity engaged in for the production of income. *Id.* § 7701(o)(5)(B).

100. See *Coltec Indus., Inc. v. United States*, 454 F.3d 1340, 1352 (Fed. Cir. 2006).

101. See *Madison*, *supra* note 18, at 443 (describing the economic substance doctrine as a tool to combat unanticipated or difficult to prevent strategies).

102. See I.R.C. § 7701(o)(1), (5)(A).

103. *Id.* § 7701(o)(5)(C).

104. The courts will continue to determine when the economic substance doctrine applies to a transaction in the same manner as if Section 7701(o) had never been enacted. *Id.* § 7701(o)(1), (5)(C).

105. See STAFF OF THE JOINT COMM. ON TAXATION, *supra* note 42, at 152–53 (stating that tax benefits are not intended to be disallowed if the realization of tax benefits from a transaction is consistent with Congress's purpose or plan with respect to the tax benefits).

ond, the transaction or series of transactions constitute a tax abusive arrangement if one of two conditions are met: either (1) the transaction does not change in a meaningful way, independent of federal income tax effects, the taxpayer's economic position or (2) the taxpayer does not have a substantial purpose, independent of federal income tax effects, for entering into the transaction.¹⁰⁶

The codified economic substance doctrine also limits a taxpayer's ability to rely on certain factors to prove that a transaction has economic substance and should be respected. For instance, Section 7701(o) allows a taxpayer to rely on a transaction's profit potential as evidence of economic substance only if the profit potential is substantially based on a present value analysis of the pre-tax profit and the net tax benefits.¹⁰⁷

Section 7701(o) also implicitly defines a tax benefit and provides the Commissioner with powers of reconstruction by referencing the case law economic substance doctrine.¹⁰⁸ A tax benefit is broadly defined as any tax benefit under Subtitle A of the Internal Revenue Code.¹⁰⁹

In addition, the government is given broad powers to disallow the tax benefits of a tax avoidance transaction.¹¹⁰ However, these powers are not as broad as the reconstruction powers granted under the typical modern GAAR. Under the economic substance doctrine, the Commissioner may reverse the tax outcome of a tax avoidance arrangement but generally may not substitute one of the possible tax outcomes that might have otherwise occurred.¹¹¹ Section 7701(o) also applies a new strict liability penalty for violations of the economic substance doctrine.¹¹²

106. I.R.C. § 7701(o)(1).

107. Specifically, "the present value of the reasonably expected pre-tax profit from the transaction [must be] substantial in relation to the present value of the expected net tax benefits that would be allowed if the transaction were respected." *Id.* § 7701(o)(2). Section 7701(o) also does not allow a taxpayer to rely on achieving a financial accounting benefit as a purpose for entering into a transaction if the origin of such financial accounting benefit is a reduction of federal income tax. *Id.* § 7701(o)(4).

108. *See id.* § 7701(o)(1), (5)(A).

109. *Id.*

110. *See id.*

111. *See, e.g.,* Klamath Strategic Inv. Fund v. United States, 568 F.3d 537 (5th Cir. 2009) (applying the economic substance doctrine to disregard for tax purposes a loan transaction that lacked economic substance and to deny the loss deductions generated by the transaction); Coltec Indus., Inc. v. United States, 454 F.3d 1340 (Fed. Cir. 2006) (applying the economic substance doctrine to strike down the loss deductions generated by a reorganization transaction, which was found to lack economic substance); *see also* Luke, *supra* note 32, at 116 (stating the economic substance doctrine generally has "all-or-nothing consequences for the taxpayer": either the claimed tax benefits are denied or the claimed tax benefits are allowed).

112. Congress amended section 6662 of the Code to add a 20% understatement penalty for disclosed transactions that lack economic substance and a 40% understatement penalty for non-disclosed transactions that lack economic substance, and also amended section 6664(c) of the Code to eliminate the reasonable cause and good faith exception for any transaction lacking economic substance. Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, § 1409(b), (c)(1), 124 Stat. 1029, 1067.

IV. JUDICIAL APPROACHES THAT UNDERMINE AND STRENGTHEN A GAAR

Despite the similarities among the GAARs, the divergence of these measures in practice is striking. As one commentator has noted, "In an international review of GAARs, the traditional GAARs have been hit-or-miss affairs."¹¹³ The different approaches taken by courts to interpret and apply a GAAR have considerably influenced a GAAR's success at identifying tax abuse and countering its detrimental effects.

This Article demonstrates that when the judiciary supports the *Duke of Westminster* principle, the judicial approaches that generally emerge are more lenient towards tax abuse. At its purest form, the *Duke of Westminster* principle excessively supports tax planning at the expense of government.¹¹⁴ Under this principle, taxpayers may minimize their taxes as long as the legal form of the transaction complies with the literal language of the statutory provision.¹¹⁵ The legislature's intention in enacting the provision and the taxpayer's motivation in entering into the transaction are completely disregarded.¹¹⁶

An analysis and comparison of the experiences in Canada, New Zealand, and Australia with a GAAR reveal that these types of judicial approaches generally weaken the ability of a GAAR to strike down tax abuse in all but the most egregious cases. Thus, these judicial approaches significantly contribute to a GAAR becoming a "miss" rather than a "hit" affair. On the other hand, courts that purposively interpret statutes, consider economic substance and other objective indicia of tax abuse in their analysis, place a reasonable burden of proof on the parties, and dis-aggregate abusive transactions from an overall business arrangement, tend to strengthen a GAAR's effectiveness.

A. METHOD OF STATUTORY INTERPRETATION

Judiciaries that support the *Duke of Westminster* principle focus on a particular tax provision's literal terms rather than on the provision's intent in determining whether a transaction obtains inappropriate tax benefits. As the experience abroad has shown, this textualist approach

113. Ed Liptak, *Battling with Boundaries: The South African GAAR Experience*, in BEYOND BOUNDARIES: DEVELOPING APPROACHES TO TAX AVOIDANCE AND TAX RISK MANAGEMENT 26 (Judith Freedman ed., 2008). Other commentators have also noted that the international experience with GAARs shows that a GAAR's effectiveness at targeting tax abuse is mixed. See Cooper, *supra* note 17, at 127; Jefferson VanderWolk, *Codification of the Economic Substance Doctrine: If We Can't Stop It, Let's Improve It*, 55 TAX NOTES INT'L 547, 547 (2009).

114. The *Duke of Westminster* principle emerged from the House of Lords' decision in *Inland Revenue Comm'r v. Duke of Westminster* in 1936. See *Inland Revenue Comm'r v. Duke of Westminster*, [1936] A.C. 1 (H.L.) (U.K.). In that case, the House of Lords employed a formalistic analysis to uphold a purely tax-motivated transaction on the basis that every taxpayer is entitled to take actions to minimize his or her taxes. See *id.*

115. See *id.* at 19 ("Every man is entitled if he can to order his affairs so as that the tax attaching under the appropriate Acts is less than it otherwise would be.").

116. See *id.*

significantly hinders a GAAR's ability to successfully counter tax abuse and often permits tax abuse to flourish.¹¹⁷

For instance, the Canadian and Australian GAARs have both faced potential emasculation by their courts' textualist approach to the GAARs. In Canada, the Canadian Supreme Court historically focused on the literal terms of the statute, rather than the statute's intent, in its tax avoidance jurisprudence.¹¹⁸ Even though the Canadian GAAR now requires courts to purposively interpret statutes to determine if an arrangement amounts to a misuse or abuse of the statute's legislative purpose, in the majority of cases, the Canadian courts continue to read statutes as textualists and adhere to a transaction's legal form.¹¹⁹ According to the Canadian Supreme Court, the Court will look for the purpose of a statute, but will not assume that the legislature intended a transaction to have any substance unless the provisions in question expressly contemplate or refer to economic substance.¹²⁰

This textualist approach significantly limits the potential application of the Canadian GAAR to tax abusive transactions. For instance, in *The Queen v. MIL (Investments) S.A.*, the Federal Court of Appeal in Canada refused to depart from the plain words of the treaty even though the Canadian Parliament specifically amended the Canadian GAAR in 2005 to clarify that the Canadian GAAR applies to treaty provisions.¹²¹ As a result, the court allowed the taxpayer to benefit from a capital gains tax exemption because the transaction complied with the literal terms of the Canada-Luxembourg treaty, notwithstanding the transaction's clear tax-saving purpose.¹²²

Similarly, in Australia, the previous Australian GAAR, Section 260, was inadequate in combating even the most blatant tax avoidance prima-

117. See Karen C. Burke, *Black & Decker in the Fourth Circuit: Tax Shelters and Textualism*, 111 TAX NOTES 315, 325 (2006); Brian Galle, *Interpretative Theory and Tax Shelter Regulation*, 26 VA. TAX REV. 357, 359-60 (2006).

118. A significant example of this textualist approach is the express refusal of the Canadian Supreme Court in *Stubart Investments Ltd. v. The Queen* to adopt a judicially developed business purpose test as a tool for limiting tax abusive activities because the test was not literally expressed by a statutory provision. See *Stubart Inv. Ltd. v. R.*, [1984] 1 S.C.R. 536 (Can.). By refusing to recognize any business purpose requirement, the Canadian Supreme Court upheld a tax benefit created through a series of transactions on paper. *Id.*

119. See Galle, *supra* note 117, at 383. For a discussion of the purposive method of statutory interpretation required by the Canadian GAAR, see *infra* Part III.A.1. The Canadian Parliament enacted the Canadian GAAR in 1988 primarily to limit the detrimental effects of this textualist judicial approach on tax abuse. See *R. v. Can. Trustco Mortg. Co.*, [2005] 2 S.C.R. 601, para. 14 (Can.).

120. *Can. Trustco*, [2005] 2 S.C.R. paras. 56, 76. Even though Parliament intended the provisions of the Canadian Income Tax Act to apply to transactions with real economic substance, the Canadian Supreme Court has interpreted Parliament's comment regarding economic substance to mean that the economic substance of an arrangement has little meaning in isolation from the proper interpretation of the specific provisions of the Act. *Id.*

121. [2007] 4 C.T.C. 235, para. 5 (Can. F.C.A.).

122. *Id.* para. 3. The evidence indicated the taxpayer entered into a series of transaction primarily to qualify under the literal terms of the treaty and obtain the tax exemption.

rily because of the formalistic approach taken by the Australian courts.¹²³ The Australian judiciary, which relied heavily on the *Duke of Westminster* principle, held that courts could disregard the legislature's "spirit and intention" when determining the Australian GAAR's application to tax avoidance.¹²⁴ This led to an explosion of aggressive tax avoidance activity in Australia in the 1970s and early 1980s.¹²⁵

Despite the foregoing, the current Australian GAAR has regained its strength as a pivotal tool in combating tax avoidance in Australia. A factor that has significantly contributed to this shift is the current Australian judiciary's adoption of a purposive method of statutory interpretation when applying and interpreting the Australian GAAR. The Australian High Court now looks beyond the mere text of the statute and seeks out the legislature's intent in enacting a particular provision when distinguishing between tax abuse and acceptable tax planning.¹²⁶ Accordingly, in *Federal Commissioner of Taxation v. Hart*, the Australian High Court unanimously applied the Australian GAAR to a particular financing arrangement described as the "Wealth Optimiser," notwithstanding that the arrangement technically complied with the statutory requirements for deducting interest expenses.¹²⁷ This judicial approach has greatly contributed to the Australian GAAR's success in challenging the taxpayer's defiance of tax liability that previously prevailed in Australia.

123. See Xynas, *supra* note 83, at 8. Section 260 initially worked well until Sir Garfield Barwick became the Chief Justice of the Australian High Court and contributed to a shift in the judicial approach to tax avoidance from the previous Australian judiciaries. Pickup, *supra* note 84, at 10.

124. See Xynas, *supra* note 83, at 9. Pursuant to this literalist approach to statutory interpretation, the Australian courts developed the "choice principle." See *Keighery Pty. Ltd. v Comm'r of Taxation* (1957) 100 CLR 66, 92 (Austl.). Under the "choice principle," taxpayers could choose between alternatives provided under a literal reading of the Australian Income Tax Act, regardless of Parliament's intention or the taxpayer's motivation. See *id.*; see also Aw, *supra* note 68, at 549–50; G.T. Pagone, *Part IVA: The General Anti-Avoidance Provisions in Australian Taxation Law*, 27 MELB. U. L. REV. 770, 774 (2003); Xynas, *supra* note 83, at 9–10.

125. Xynas, *supra* note 83, at 10–12. For a description of the tax abuse that resulted in Australia prior to Parliament amending the Australian GAAR, see *id.* at 6–10.

126. See Chris Evans, *The Battle Continues: Recent Australian Experience with Statutory Avoidance and Disclosure Rules*, in BEYOND BOUNDARIES: DEVELOPING APPROACHES TO TAX AVOIDANCE AND TAX RISK MANAGEMENT 37, 41 (Judith Freedman ed., 2008); Xynas, *supra* note 83, at 37; see, e.g., *Comm'r of Taxation v Consol. Press Holdings Ltd.* (2001) 207 CLR 235 (Austl.) (considering the policy and purpose of the relevant provisions in concluding a specific provision giving rise to a tax liability applies to the transaction at issue).

127. (2004) 217 CLR 216 (Austl.). In *Hart*, the taxpayers acquired a loan from a mortgage broker to (i) purchase a primary residence, which is ineligible for interest deductions, and (ii) re-finance an investment property, which qualifies for interest deductions. *Id.* at 229. The evidence indicated that, pursuant to the "Wealth Optimiser" strategy, the parties then split the loan into two accounts and used non-standard financing features for the sole purpose of creating additional deductible interest payments on the investment property account and minimizing the non-deductible interest payments on the residence account. *Id.* at 229–30. The taxpayers then claimed these additional interest payments as tax deductions, because technically the payments were attributable to the investment property and, therefore, qualified as deductible interest payments. *Id.* at 230.

The New Zealand Supreme Court has also adopted a purposive approach, which has prevented many abusive transactions from escaping the reach of the New Zealand GAAR.¹²⁸ According to the New Zealand Supreme Court, the New Zealand GAAR requires a taxpayer to satisfy two conditions to preclude the GAAR's application.¹²⁹ First, the taxpayer must demonstrate that the transaction complies with the applicable specific provisions of the New Zealand Income Tax Act in a manner that is within its intended scope.¹³⁰ This determination is based primarily on the ordinary meaning of the specific provision, as established through its text in light of its specific purpose.¹³¹ If that is shown, the taxpayer must also establish that the taxpayer used the specific provisions in a manner that was "within Parliament's purpose and contemplation when it enacted them."¹³² If the taxpayer fails to do so, the arrangement will be a tax avoidance arrangement and void against the Commissioner under the New Zealand GAAR. Pursuant to this approach, it is not enough for a transaction to literally comply with a specific tax provision for the taxpayer to obtain the resulting tax benefit.

As the international experience has shown, courts that employ a formalistic method of statutory interpretation enable taxpayers to exploit the law to generate tax benefits merely by complying with that law's textual requirements. However, merely complying with a statute's literal requirements does not always generate the results that were intended by the legislature. Therefore, it is critical for courts to determine and consider legislative intent when applying a GAAR to a transaction to correctly distinguish between tax abuse and legitimate tax planning.¹³³ Even though the tax avoidance jurisprudence indicates that a GAAR can still

128. See, e.g., *Penny v Comm'r of Inland Revenue* [2012] 1 NZLR 433 (SC) para [54] (N.Z.) (holding that even though the taxpayers' transfer of their respective businesses to companies owned by their family trusts was entirely lawful, the use of the business structure to pay an artificially low salary to the taxpayers and avoid payment of the highest personal tax rate was beyond parliamentary contemplation); *Glenharrow Holdings Ltd. v Comm'r of Inland Revenue* [2009] 2 NZLR 359 (SC) para [34] (N.Z.) (looking "beyond the technical legality of the constituent parts of an arrangement" to conclude an arrangement is tax abusive).

129. *Ben Nevis Forestry Ventures Ltd. v Comm'r of Inland Revenue* [2009] 2 NZLR 289 (SC) para [107] (N.Z.).

130. *Id.* If the first test is not met, the New Zealand GAAR is not applicable. Instead, the court will deny the taxpayer the claimed tax benefits under the specific provision of the New Zealand Income Tax Act. *Id.*

131. *Id.* On the contrary, the minority in *Ben Nevis* endorsed an expansive purposive analysis of the specific provisions to minimize the use of the GAAR in all but the most offensive arrangements. *Id.* at para [9] (Elias C.J., Anderson, J., dissenting); Aw, *supra* note 68, at 561.

132. *Ben Nevis*, [2009] 2 NZLR para [156] (majority opinion). This "parliamentary contemplation" test is not a new approach to analyzing tax avoidance cases in New Zealand. It was previously referred to as the "scheme and purpose" approach. *Id.* para [100]. The New Zealand Supreme Court has slightly modified this approach by revising its name and explicitly acknowledging that the determination is made by construing specific tax provisions and the New Zealand GAAR in tandem so that each is given appropriate effect. *Id.* para [103]; see Craig Elliffe & Jess Cameron, *The Test for Tax Avoidance in New Zealand: A Judicial Sea of Change*, 16 N.Z. Bus. L.Q. 440, 446 (2010).

133. See Lederman, *supra* note 26, at 395–96.

apply in litigated cases where the court employs a textualist approach, it is not likely to apply to tax abusive transactions when the legislative intent with respect to a specific provision is not as clear.¹³⁴ By disregarding policy and other considerations, a textualist approach undermines a GAAR's ability to effectively identify and target tax abusive transactions, thereby limiting the potential effectiveness of a GAAR.

B. CONSIDERATION OF ECONOMIC SUBSTANCE

Courts that consider a transaction's economic substance, or lack thereof, when determining whether the transaction is abusive generally increase a GAAR's effectiveness at identifying and countering tax abuse, while the failure to do so generally undermines a GAAR's effectiveness. As one commentator has observed, "Any GAAR or general anti-avoidance doctrine must consider the economic substance of transactions if it is to be effective."¹³⁵

The Canadian experience with a GAAR reveals the detrimental effects of failing to require transactions to have economic substance for the transaction to be respected for tax purposes. In Canada, the judiciary generally refuses to consider the arrangement's economic substance in determining whether a transaction is abusive. Specifically, the Canadian Supreme Court has held that a lack of economic substance does not render a transaction abusive for purposes of the Canadian GAAR unless the provisions in question contemplate or refer to economic substance.¹³⁶ Even if they do, the Canadian Supreme Court treats the lack of economic substance as merely one factor and insufficient, in itself, to establish abusive tax avoidance.¹³⁷ Because few statutory provisions explicitly refer to economic substance, this judicial approach makes economic substance unlikely to be an important factor in the application of the Canadian GAAR.¹³⁸ As a result, the Canadian GAAR fails to counteract many tax abusive transactions that are implicitly contrary to the legislature's intent.

Thus, in countries such as Canada, where the judiciary refuses to consider economic substance, the GAAR has been much less effective at distinguishing between tax abuse and tax planning. For instance, in *The Queen v. Canada Trustco Mortgage Co.*, a sale-leaseback transaction es-

134. See Arnold, *supra* note 23, at 32; Van Der Hout, *supra* note 23, at 46. For examples of cases where the government has prevailed despite the textualist approach adopted by courts see, for example, *Cophorne Holdings Ltd. v. R.* (2011), 339 D.L.R. 4th 385 (Can. S.C.C.) (applying the Canadian GAAR because the text and context of the relevant tax provision contained a specific parliamentary intent that the transaction misused); *Mathew v. R.*, [2005] 2 S.C.R. 643 (Can.) (applying the Canadian GAAR even though the transaction complied with the literal terms of the statute because there was clear abuse or misuse of the relevant provision).

135. Arnold, *supra* note 23, at 31. Other commentators also agree that economic substance is an important factor in evaluating whether transactions are abusive tax avoidance transactions. See, e.g., Pichhadze & Pichhadze, *supra* note 17, at 61.

136. *R. v. Can. Trustco Mortg. Co.*, [2005] 2 S.C.R. 601, paras. 56-60 (Can.).

137. *Id.*

138. See Arnold, *supra* note 23, at 31.

caped the reach of the Canadian GAAR despite the transaction's extensive tax shelter characteristics.¹³⁹ The transaction was unreasonably complex and involved the circular flow of money as well as other pre-ordained and economically unnecessary steps to obtain the desired tax benefits. The evidence indicated that the transaction clearly lacked any economic substance, independent of the tax benefits. Specifically, the evidence showed that the taxpayer essentially manufactured a cost for purposes of the capital cost allowance without incurring any economic expense or any economic risk.¹⁴⁰ After the transaction, the taxpayer neither economically owned the purchased property nor economically paid for the property.¹⁴¹ Despite the foregoing, the Canadian Supreme Court did not consider this lack of economic substance as relevant to its tax abuse analysis. Instead, it disregarded this evidence because the capital cost allowance provisions giving rise to the substantial deductions at issue did not expressly refer to "economic risk."¹⁴² As a result, the Canadian GAAR failed to identify and counteract this tax abusive arrangement.¹⁴³

On the other hand, the Australian and New Zealand experiences with a GAAR show that taking into account a transaction's economic substance is an effective strategy for identifying tax abuse. In Australia, the courts have used the Australian GAAR to strike down transactions that lack economic substance and were abusive. For instance, in *Commissioner of Taxation v. Hart*, the Australian High Court used the Australian GAAR to disregard the additional interest deductions generated by the "Wealth Optimiser" financing arrangement,¹⁴⁴ partly because the transaction lacked economic substance.¹⁴⁵ The evidence showed that neither the taxpayer nor the lender's financial position changed and no other consequences resulted or were reasonably expected to result from the scheme other than the additional interest deductions arising from the non-standard financing features of the loan.¹⁴⁶ As required by Part IVA's statutory language, the Australian High Court considered this lack of any economic effects other than tax benefits as relevant to its tax abuse analy-

139. [2005] 2 S.C.R. paras. 68, 73 (Can.).

140. *Id.* paras. 2–3.

141. *Id.* para. 70. The taxpayer also conceded that it entered into the transaction primarily to generate the cost allowance deductions. *Id.* para. 1.

142. *Id.* para. 75.

143. On the other hand, in the United States, courts have characterized numerous sale-leaseback transactions that exhibit similar tax shelter characteristics as tax abuse and disallowed the corresponding benefits. *See, e.g., Rice's Toyota World v. Comm'r*, 752 F.2d 89 (4th Cir. 1985) (characterizing as tax abuse a purported sale-leaseback transaction in which no reasonable possibility of profit existed, the purchased equipment was unnecessary and unrelated to the taxpayer's business, the transaction lacked tax-independent considerations, and the taxpayer had no economic risk of loss with respect to the property). *Cf. Frank Lyon Co. v. United States*, 435 U.S. 561 (1978) (respecting a sale-leaseback transaction for tax purposes, because the taxpayer incurred some economic risk with respect to the transaction and the transaction involved independent parties).

144. *See supra* note 127 and accompanying text.

145. *Comm'r of Taxation v Hart* (2004) 217 CLR 216, 262 (Austl.).

146. *Id.* at 244–45.

sis. Consequently, the Australian High Court used this evidence to support its conclusion that the taxpayer's dominant purpose in entering into the transaction was to obtain a tax benefit, which constituted tax abuse under the Australian GAAR.¹⁴⁷

Similarly, New Zealand courts also look to the arrangement's economic substance and do not limit their analysis to purely legal considerations when determining whether a transaction's use of a specific provision is contrary to Parliament's intent.¹⁴⁸ For instance, in *Glenharrow Holdings Ltd. v. Commissioner of Inland Revenue*, after taking the arrangement's lack of economic substance into account, the New Zealand Supreme Court applied the New Zealand GAAR to deny a tax refund arising from a mining license purchase.¹⁴⁹ The New Zealand Supreme Court characterized the transaction as a tax avoidance arrangement and denied the corresponding tax benefits under the New Zealand GAAR, partly because the tax benefit was completely disproportionate to the economic burden undertaken by the taxpayer.¹⁵⁰ Thus, by placing increasing importance on the economic effect and commercial realities of a transaction in distinguishing between tax abuse and acceptable tax planning, the New Zealand Supreme Court increases the likelihood that courts will "call a spade a spade."¹⁵¹

C. CONSIDERATION OF OBJECTIVE FACTORS

In addition, the experience abroad has shown that courts that refuse to consider certain objective indicia of tax avoidance or, instead, emphasize subjective factors in their tax abuse analysis often hinder a GAAR's ability to distinguish tax abusive transactions from acceptable tax planning. An inquiry into a taxpayer's subjective intent is often not helpful at iden-

147. *Id.* at 262–63.

148. *Ben Nevis Forestry Ventures Ltd. v. Comm'r of Inland Revenue* [2009] 2 NZLR 289 (SC) para [109] (N.Z.) (stating that the ultimate question in determining whether the New Zealand GAAR applies to a transaction is "whether the impugned arrangement, viewed in a commercially and economically realistic way, makes use of the specific provision in a manner that is consistent with Parliament's purpose").

149. [2009] 2 NZLR 359 (SC) para [54] (N.Z.).

150. Even though this case dealt with the general anti-avoidance rule in the Goods and Services Act, rather than the New Zealand Income Tax Act, the New Zealand Supreme Court's approach in *Glenharrow* applies equally in tax avoidance cases under the Income Tax Act 1994. *Comm'r of Inland Revenue v Penny* [2010] 3 NZLR 360 (CA) para [67] (N.Z.), *aff'd*, [2012] 1 NZLR 433 (SC).

In *Glenharrow*, the Court concluded that an objective view of the circumstances revealed the taxpayer did not incur any economic expense for the mining license and the vendor did not obtain any economic benefit. Specifically, it was commercially impossible that the taxpayer would pay the vendor because the assets to be used for repayment were shrinking in value and had a limited practical life, there was a gross disparity between the price and the size of the purchaser, and the purchaser was virtually un-capitalized, and the obligation, although a legal obligation, was not supported by its shareholder. *Glenharrow*, [2009] 2 NZLR 359 paras [51–54].

151. See *Ben Nevis* [2009] 2 NZLR 289 para [109]; Elliffe & Cameron, *supra* note 132, at 455. While New Zealand courts have always had this ability to consider economic substance in the context of tax avoidance cases, the courts' propensity to use it has varied. Elliffe & Cameron, *supra* note 132, at 455.

tifying tax abusive transactions because a purely tax-motivated transaction is not always abusive. In some instances, the legislature may have intended for the tax benefits to encourage taxpayers to make a particular investment or to engage in a particular activity.¹⁵² Both courts and taxpayers can also easily manipulate this factor, which further decreases its usefulness.¹⁵³ For instance, most sophisticated, or at least prudent, taxpayers consider taxes in arranging their affairs regardless of whether the transaction is legitimate or abusive.¹⁵⁴ Thus, if the court believes the arrangement “smells” bad and wants to disregard the transaction, it may easily find some evidence of the taxpayer’s intent to avoid taxes.¹⁵⁵ On the other hand, taxpayers can also manipulate this factor by manufacturing evidence of their own intent, such as developing a business purpose for a tax strategy after the transaction has been completed.¹⁵⁶

Accordingly, courts reduce potential manipulation and thereby increase a GAAR’s effectiveness and its fair application by focusing on the objective purpose of the transaction and disregarding the taxpayer’s subjective tax motivation in determining whether or not to uphold the claimed tax result. For instance, the statutory requirement to consider certain objective factors as relevant in the tax abuse analysis has strengthened the Australian GAAR’s effectiveness.¹⁵⁷ As stated by the Australia

152. For instance, in the United States, the low-income housing credit in section 42 of the Code, the production tax credit in section 45 of the Code, and the energy credit in section 48 of the Code are a few examples of tax credits that were created to incentivize taxpayers to engage in a particular behavior. See STAFF OF THE JOINT COMM. ON TAXATION, *supra* note 42, at 152.

153. See Lederman, *supra* note 26, at 392.

154. *Id.* at 417–18 (arguing that a false dichotomy exists because all profit-motivated transactions in a world with taxes are motivated by after-tax profit).

155. Madison, *supra* note 18, at n.33 (citing *ACM P’ship v. Comm’r*, 157 F.3d 231, 265 (3d Cir. 1998) (McKee J., dissenting) (“If the scheme in question smells bad, the intent to avoid taxes defines the result as we do not want the taxpayer to ‘put one over.’”)).

156. Lederman, *supra* note 26, at 398.

157. See *Income Tax Assessment Act 1936* (Cth) s 177D(b) (Austl.) (identifying eight statutory factors to be taken into account in determining whether a dominant tax avoidance purpose exists); *Comm’r of Taxation v Hart* (2004) 217 CLR 216, 240–41 (Austl.) (requiring courts to consider whether it would be concluded “having regard to the eight matters listed in [the statute], that a person who entered into or carried out the . . . scheme, did so for the dominant purpose of enabling the [taxpayer] to obtain a tax benefit in connection with the scheme”).

However, the analysis in Australia is not entirely dependent on only objective factors. According to the Australian High Court, the determination of an arrangement’s purpose also depends on whether having regard to the factors described in the statute, a reasonable person would conclude that the taxpayer entered into or carried out the scheme for the dominant purpose of enabling the taxpayer to obtain a tax benefit. *Comm’r of Taxation v Spotless Servs. Ltd.* (1996) 186 CLR 404, 422 (Austl.). Thus, courts must consider what other possibilities existed when determining whether the eight statutory factors indicate that the dominant purpose was to obtain tax benefits. *Hart*, 217 CLR at 244–45. The reasonable person standard has given rise to difficult litigation and potentially difficult questions of interpretation. The application of this reasonable person standard often depends on how a particular court views the facts and the objective purpose of the scheme, which is often in the “eye of the beholder.” For a further description of this issue refer to G.T. Pagone’s discussion in Hon. J. G.T. Pagone, Part IVA: Where Are We and Where Are We Going? The Big Picture, Address Before the Tax Institute of Australia (Mar. 1, 2011). Australian courts apply a similar reasonable person standard in determining

lian High Court, one reason the Australian Parliament made the Australian GAAR's application dependent on the objective factors listed in the statute was to avoid having the operation of Part IVA depend on the "fiscal awareness of [the] taxpayer."¹⁵⁸ Therefore, in Australia, a taxpayer cannot succeed in defending an assessment under the Australian GAAR by relying upon the lack of a subjective intent to obtain a tax benefit.¹⁵⁹

Similarly, the New Zealand GAAR has also proven to be effective, partly because the New Zealand GAAR's application is not contingent on the taxpayer's subjective tax motive or purpose. Instead, the New Zealand GAAR applies when the court is satisfied that the arrangement's objective purpose is to defeat the intent and purpose of the tax act or any of its provisions.¹⁶⁰ Therefore, even if the evidence does not indicate that the taxpayer had a tax avoidance purpose, if the court deduces a tax avoidance purpose from the arrangement itself, or from the arrangement's effect, the taxpayer may be denied the transaction's tax benefits.¹⁶¹

The New Zealand Supreme Court, rather than Parliament, has identified certain factors as relevant, but not determinative, in identifying tax abuse under the New Zealand GAAR.¹⁶² Furthermore, the New Zealand tax avoidance jurisprudence illustrates how taking into account these indicia of tax avoidance increases the likelihood that a GAAR will capture tax avoidance arrangements that are contrary to parliamentary contemplation. For instance, in *Ben Nevis*, after considering the objective evidence, the New Zealand Supreme Court concluded the transaction was outside of parliamentary intent and therefore an abusive tax avoidance transaction under the New Zealand GAAR.¹⁶³ The transaction involved an investment in a forest development syndicate, known as the "Trinity Scheme," which was designed to generate tax deductions through

whether it is reasonable to expect that the tax benefit claimed by the taxpayer was derived from the scheme. *Comm'r of Taxation v Peabody* (1994) 181 CLR 359, 363 (Austl.).

158. *Comm'r of Taxation v Consol. Press Holdings Ltd.* (2001) 207 CLR 235, 264 (Austl.).

159. *Hart*, 217 CLR at 243.

160. *Ben Nevis Forestry Ventures Ltd. v Comm'r of Inland Revenue* [2009] 2 NZLR 289 (SC) paras [35, 37] (N.Z.).

However, despite this approach taken by the New Zealand Supreme Court, the courts continue to introduce some subjective elements to the GAAR analysis, which potentially results in over-application of the New Zealand GAAR. For instance, the New Zealand Supreme Court has also indicated that the artificial or contrived nature of a transaction is highly relevant to determining whether a transaction is abusive. *Id.* para [108]. This factor is often a subjective determination. Thus, there is risk that tax avoidance determinations utilizing this factor will be based on an instinctive view of the merits of the tax outcomes. Trombitas, *supra* note 27, at 366.

161. See *Ben Nevis*, [2009] 2 NZLR 289 para [39].

162. These possible factors include "the manner in which the arrangement is carried out . . . the role of all the relevant parties and any relationship they may have with the taxpayer[,] . . . the economic and commercial effects of documents and transactions[,] . . . the duration of the arrangement and the nature and extent of the financial consequences that it will have for the taxpayer." *Id.* para [108].

163. *Id.*

promissory notes.¹⁶⁴ As a result of the arrangement, the taxpayers obtained a tax benefit because the promissory notes caused the taxpayers to incur expenses for tax purposes. But, in reality, the notes were not subject to cash payments for approximately fifty years. The New Zealand Supreme Court concluded that the excessive length of time between the incurrence of the expense and the date of repayment, together with the absence of securities over other assets or personal guarantees from the taxpayers' shareholders, indicated that the taxpayers would probably never repay the notes with their own resources. Moreover, the prospects of profit were remote at the time the arrangement was entered into, the notes were commercially unnecessary, and the notes did not give rise to economic consequences on either side.¹⁶⁵ Because the objective evidence indicated that the transaction was abusive, the New Zealand Supreme Court applied the New Zealand GAAR to override the taxpayers' claimed tax benefits from the transaction.¹⁶⁶

On the contrary, the Canadian Supreme Court undermines the potential effectiveness of the Canadian GAAR by limiting the objective factors that may be considered in determining whether a tax avoidance transaction is abusive. The Canadian Supreme Court does so by focusing primarily on whether the taxpayer complied with the literal terms of the statute. Specifically, in accordance with the *Duke of Westminster* principle, the Canadian Supreme Court generally supports the proposition that a taxpayer is subject to tax based on what the taxpayer legally did. However, by disregarding the economic substance of what was done, the Canadian courts exclude a relevant indicia of tax avoidance from their tax abuse analysis to the detriment of the Canadian GAAR's usefulness.¹⁶⁷ Thus, the Canadian courts omit an objective factor that could be significantly relevant for determining whether the use of specific statutory provisions is outside of the legislature's intent and, consequently, abusive.

D. BURDEN OF PROOF

The burden of proof in establishing the existence or lack of tax abuse under a GAAR also contributes to the strength of a GAAR as an anti-abuse tool. To the extent this burden of proof is reasonable, it should not impact a GAAR's effectiveness. But when a judiciary imposes an unreasonably onerous burden of proof on either party, a GAAR can lose some of its effectiveness in countering abusive transactions.

For instance, many countries place the burden of proving that a trans-

164. *Id.* para [14].

165. *Id.* para [147]. The Court characterized the promissory note as an artificial element of the arrangement because it was given before the expenditure was incurred, which from a business point of view is a gratuitous mechanism and lacked economic effect. In reality, the promissory notes constituted an artificial payment implemented for taxation purposes. *Id.* paras [119, 147].

166. *Id.* para [148].

167. See Tom Akin et al., *Economic Substance Around the World (Part 1)*, 16 J. INT'L TAX'N 50, 56 (2005); R. v. Can. Trustco Mortg. Co., [2005] 2 S.C.R. 601, para. 11 (Can.).

action constitutes legitimate tax planning on the taxpayer.¹⁶⁸ In New Zealand, the taxpayer has the burden of proof in tax controversies that involve the application of the New Zealand GAAR¹⁶⁹ and, thus, the burden of proving that the arrangement is within Parliament's intention.¹⁷⁰ This approach likely facilitates the government's ability to use a GAAR to successfully counter more tax-abusive transactions. But this approach potentially also leads to over-application of the GAAR because, in these situations, taxpayers often face an uphill battle to satisfy this burden of proof when accused by the Commissioner of tax avoidance.¹⁷¹

On the other hand, judiciaries that support the *Duke of Westminster* principle generally attempt to protect a taxpayer's right to plan tax strategy from an unpredictable application of a GAAR. In doing so, these judiciaries often shift the burden to prove the abusive nature of the transaction to the government. For instance, in Canada, the government has the burden of proving that the Canadian GAAR applies to a transaction before a court will apply the Canadian GAAR to invalidate a transaction.¹⁷² However, the Canadian Supreme Court has not only shifted the burden of proving the abusive nature of the transaction to the government, but has also imposed a high evidentiary threshold for applying the Canadian GAAR.¹⁷³ Specifically, to justify the Canadian GAAR's application, the Minister must both clearly identify the legislative intent of the provisions that have allegedly been frustrated or defeated, as well as establish that the transaction clearly frustrates that purpose.¹⁷⁴ If the abusive nature of the transaction is not clear, the benefit of the doubt goes to the taxpayer.¹⁷⁵ The Minister must also overcome the initial assumption that the tax benefit conferred by the plain words of the statutory provision is not abusive.¹⁷⁶

The Canadian experience illustrates that when the judiciary imposes an unreasonably onerous burden of proof on the government, they effectively limit the potential application of a GAAR. As a result of this judicial approach, taxpayers may successfully engage in a broader range of tax-minimizing activities without coming in conflict with the Canadian GAAR. In addition, judges who are sympathetic to tax avoidance activities will find it easier to rationalize not applying the Canadian GAAR.¹⁷⁷

168. See, e.g., *Comm'r of Inland Revenue v Penny* [2010] 3 NZLR 360 (CA) para [69] (N.Z.) (stating the taxpayer has the burden of proof in New Zealand), *aff'd*, [2012] 1 NZLR 433 (SC); see also Cooper, *supra* note 17, at 102 (concluding that the international experience with GAARs reveals that once the GAAR is triggered, the burden is generally on the taxpayer to disprove its applicability).

169. *Penny*, [2010] 3 NZLR 360 para [69].

170. *Id.*

171. See Aw, *supra* note 68, at 557–58.

172. *R. v. Can. Trustco Mortg. Co.*, [2005] 2 S.C.R. 601, paras. 62, 65–66 (Can.).

173. *Id.*

174. *Id.*

175. *Id.*

176. *Id.* para. 17.

177. See, e.g., *Lehigh Cement Ltd. v. R.*, [2010] 5 C.T.C. 13 (Can. CA) (permitting a taxpayer to engage in a debt-restructuring arrangement with non-commercial features for

Accordingly, in *Lehigh Cement Ltd. v. The Queen*, the Federal Court of Appeal, unanimously reversing the Tax Court's decision, upheld a taxpayer's debt restructuring arrangement.¹⁷⁸ The taxpayer entered into the arrangement for the sole purpose of obtaining a withholding tax exemption on its current interest payments to a foreign affiliate. The Tax Court characterized the transaction as abusive tax avoidance because the "object, spirit and purpose" of the withholding tax exemption was to help Canadian corporations increase their access to international markets, but, in reality, this arrangement did not increase the corporation's access to an international market.¹⁷⁹ But the Federal Court of Appeal disagreed. The Court of Appeal concluded that the Minister failed to *clearly* establish this particular purpose.¹⁸⁰ Even though the disputed arrangement violated the legislative purpose of the provision, the Federal Court of Appeal respected the transaction as legitimate tax planning.¹⁸¹

E. METHOD OF IDENTIFYING THE RELEVANT SCHEME

In addition, a court's willingness to disaggregate transactions and test each transaction individually when applying a GAAR is critical to increasing a GAAR's effectiveness at identifying and countering tax abuse. The literature has also recognized the importance of this factor.¹⁸² As the scholar Leandra Lederman observed, "[T]he fact that a strategy is integrated into the taxpayer's business, rather than existing alongside it, should not affect the determination of whether that strategy is abusive[,] [because] [i]f the activity is abusive, it is socially wasteful regardless of how connected it is to the taxpayer's business."¹⁸³ Without a court's ability to disaggregate transactions and apply a GAAR to individual steps within a larger transaction, taxpayers can easily manipulate transactions to satisfy a GAAR by inserting abusive transactions into an overall legitimate business scheme.

Accordingly, the Australian High Court has strengthened the Australian GAAR's effectiveness by holding that the Australian GAAR can apply even if a rational commercial purpose exists for the transaction.¹⁸⁴ Specifically, in Australia, the existence of an overall commercial purpose

the sole purpose of obtaining tax benefits), *rev'd in part* *Lehigh Cement Ltd. v. R.*, [2009] D.T.C. 776; Brian J. Arnold, *The Long, Slow, Steady Demise of the General Anti-Avoidance Rule*, 52 CAN. TAX J. 488, 498 (2004).

178. [2010] 5 C.T.C. 13, para. 44. To comply with the technical requirements of the withholding tax exemption, the parties modified and sold the future interest payments on the loan to an unrelated foreign bank. However, the parties structured the transaction so that the unrelated foreign bank incurred no economic risk of loss on its investment and the foreign affiliate retained its right to receive the principal payments on the debt. *Id.* paras. 11–17.

179. *Id.* para. 19.

180. *Id.* para. 44.

181. *Id.*

182. See Lederman, *supra* note 26, at 393, 402; McMahon, *supra* note 17, at 1728.

183. Lederman, *supra* note 26, at 402.

184. *Comm'r of Taxation v Consol. Press Holdings Ltd.* (2001) 207 CLR 235, 264 (Austl.); *Comm'r of Taxation v Spotless Serv. Ltd.* (1996) 186 CLR 404, 407 (Austl.).

for an arrangement is not determinative. Instead, if part of an arrangement has a “ruling, prevailing or most influential” tax avoidance purpose, the Commissioner and the courts may apply the Australian GAAR to that portion of the arrangement and deny the taxpayer the tax benefits from that step.¹⁸⁵ For instance, in *Federal Commissioner of Taxation v. Consolidated Press Holdings Ltd.*, the High Court applied the Australian GAAR to a scheme that had a dominant tax avoidance purpose, even though the scheme was part of the taxpayer’s financing of a takeover bid, which clearly had a commercial purpose when taken as a whole.¹⁸⁶ By disaggregating the transaction, the High Court was able to deny the taxpayer the tax benefits generated in a transaction that undermined the legislative purpose of the provision.¹⁸⁷

Similarly, the New Zealand Supreme Court has also strengthened the New Zealand GAAR’s effectiveness by recognizing that “tax avoidance can be found in the individual steps” in an arrangement or “in a combination of steps.”¹⁸⁸ As a result, even though an arrangement has an overall business purpose, the New Zealand Supreme Court has refused to find that the insertion of a step with a tax avoidance purpose into that arrangement shields that step from the New Zealand GAAR’s application when that step generates tax benefits in a manner that is beyond parliamentary contemplation.¹⁸⁹ For instance, in *Penny & Hooper*, the New Zealand Supreme Court appears to have correctly disaggregated from an overall legitimate business arrangement a tax abusive transaction.¹⁹⁰ The evidence indicated that the taxpayers used a legitimate business structure to pay themselves artificially low salaries in order to re-characterize the remainder of their earnings as company dividends.¹⁹¹ As a result, the

185. *Comm’r of Taxation v Hart* (2004) 217 CLR 216, 242–43 (Austl.) (clarifying its earlier decision in *Peabody* by concluding that the Commissioner may focus on the tax-driven portion of a transaction even if the overall transaction is done for legitimate commercial purposes); *Consol. Press*, 207 CLR at 264 (stating that it is not “artificial and inappropriate” to observe that a portion of an overall commercial transaction has a dominant tax avoidance purpose); *Spotless*, 186 CLR at 423 (defining the term “dominant” pursuant to its ordinary meaning).

186. 207 CLR at 264. In this case, the Court determined that one part of the transaction—the interposition of an otherwise dormant entity into the transaction—was entered into primarily to obtain a tax benefit and the Court therefore disallowed the tax benefit. *Id.* at 264–65.

187. *See id.*

188. *Ben Nevis Forestry Ventures Ltd. v Comm’r of Inland Revenue* [2009] 2 NZLR 289 (SC) para [105] (N.Z.).

189. *See id.*; *Penny v Comm’r of Inland Revenue* [2012] 1 NZLR 433 (SC) para [49] (N.Z.).

190. *See Penny*, [2012] 1 NZLR 433 para 49.

191. *Id.* para 35. In *Penny*, two surgeons, who conducted their practice on their own account, each formed a family company to purchase their practice and transferred the practice to that company. *Id.* para 1. Following the transfer, the company paid the relevant surgeon a salary, which the parties conceded was commercially unrealistic, and substantially lower than the income each surgeon previously derived. *Id.* paras 14–16. By retaining the majority of the surgeon’s wages in the company and treating only an artificially low amount as the surgeon’s salary, each surgeon received the benefit of a lower company tax rate than the higher marginal tax rate applicable to his personal income. *Id.* para 35.

taxpayers were taxed on the majority of their earnings at the much lower dividend tax rate without suffering any corresponding economic harm.¹⁹² The Court held that even though the use of the corporate structure was lawful, the taxpayers' payment of a commercially unreasonable salary was an artificial method to generate tax benefits that were not intended by Parliament.¹⁹³ Therefore, the New Zealand Supreme Court characterized that step in the business arrangement as a tax abusive transaction under the New Zealand GAAR.¹⁹⁴

V. THE EFFECTIVENESS OF THE CODIFIED ECONOMIC SUBSTANCE DOCTRINE

We have yet to see whether the newly enacted Section 7701(o) will be effective at fighting tax abuse. This Article argues that the Canadian, Australian, and New Zealand experiences with GAARs demonstrate us that although Section 7701(o) is not a universal cure for tax abuse, it can be used to identify and counter many of the aggressive tax abuse schemes that undermine our tax system. The overall statutory language of Section 7701(o), together with the judicial approaches that U.S. courts have previously adopted with respect to the economic substance doctrine, are consistent with many approaches taken abroad that tend to strengthen a GAAR. However, the international experience also reveals certain challenges that will likely arise in our use of Section 7701(o) as an anti-abuse measure. Thus, this Article proposes several statutory amendments and other steps we can take to avoid some of the pitfalls that could limit Section 7701(o)'s effectiveness in minimizing tax abuse in the United States.

A. TREND FROM PURPOSIVE TO TEXTUALIST INTERPRETATION

The United States has never adopted the *Duke of Westminster* principle, which has contributed to the United States' development and previous successes with the common law economic substance doctrine as an anti-abuse measure.¹⁹⁵ In fact, at approximately the same time the House of Lords rendered the *Duke of Westminster* decision in the United Kingdom, the United States Supreme Court rendered its decision in *Gregory v. Helvering*. In *Gregory*, the U.S. Supreme Court emphasized that taxpayers do not have an absolute right to arrange their affairs in a manner that minimizes taxes.¹⁹⁶ Unlike the *Duke of Westminster* princi-

192. *Id.* para 2.

193. *Id.* para 49.

194. *Id.* paras 49, 54.

195. As examples of cases where courts have held that a transaction that complies with the literal terms of the Code is abusive, *see, e.g.*, *Gregory v. Helvering*, 293 U.S. 465 (1935); *Klamath Strategic Inv. Fund v. United States*, 568 F.3d 537 (5th Cir. 2009); *Coltec Indus., Inc. v. United States*, 454 F.3d 1340 (Fed. Cir. 2006).

196. *Gregory*, 293 U.S. at 465. In this case, the Supreme Court established the substance-over-form doctrine, as well as the basis of the other judicial doctrines that focus on the transaction's substance rather than solely its legal form. *Id.* at 469–70. The related judicial anti-abuse doctrines include the business purpose doctrine, the step transaction doctrine, the sham doctrine, and the economic substance doctrine. Yoram Keinan, *The*

ple, U.S. courts must focus on a transaction's substance and a tax provision's purpose, rather than solely on the provision's literal text, when determining whether to respect a transaction as legitimate tax planning.¹⁹⁷

By rejecting the application of the *Duke of Westminster* principle, the U.S. Supreme Court effectively adopted a purposive approach with respect to tax statutes and influenced the creation of the economic substance doctrine. As the international experiences with a GAAR indicate, a textualist approach to statutory interpretation undermines a GAAR's effectiveness. Thus, the American courts' adoption of a generally purposive approach to statutory interpretation has historically helped counter tax abuse in the United States by disregarding numerous transactions that intentionally circumvented the legislative purpose of a provision to reap tax benefits.¹⁹⁸

However, recent U.S. tax jurisprudence indicates a trend toward "plain text" statutory interpretation, without regard to context or policy.¹⁹⁹ Significantly, in 2001 the U.S. Supreme Court applied a textualist approach to uphold a transaction that generated a "double windfall" of tax benefits in *Gilutz v. Commissioner of Internal Revenue*.²⁰⁰ Specifically, the Supreme Court stated: "[B]ecause the Code's plain text permits the taxpayers here to receive these benefits, we need not address this policy concern."²⁰¹ Since then, numerous courts have applied a similar textualist approach to uphold transactions that literally comply with the statutory requirements of a provision.²⁰² They have done so by narrowly interpreting the economic substance doctrine or refusing to apply the doctrine altogether. Unfortunately, this trend toward textualism has un-

Economic Substance Doctrine—Past, Present, and Future, 47 TAX MGMT. MEMO. 259 (2006).

197. See *Gregory*, 293 U.S. at 468–69.

198. See, e.g., *id.* at 470 (denying the tax benefit arising from a reorganization because Congress intended for reorganizations to have a business purpose, and the reorganization in the instant case lacked a business purpose); *Knetsch v. United States*, 364 U.S. 361, 367 (1960) (denying the claimed interest deduction generated by a purported loan because Congress did not intend for the relevant Code provision to allow a deduction under these circumstances).

199. See *Galle*, *supra* note 117, at 358–59; *Madison*, *supra* note 18, at 458; *Pichhadze & Pichhadze*, *supra* note 17, at 63.

200. 531 U.S. 206, 219–20 (2001). Shareholders of an S-corporation obtained a double tax benefit by using discharge of debt income, which was excluded from the gross income of the insolvent S-corporation, to increase their basis in the S-corporation and then deduct on their personal income tax returns the S-corporation's losses and deductions. *Id.* at 208–10. However, the double tax benefit obtained by the taxpayers in *Gilutz* has been overruled by legislation and is no longer available to taxpayers pursuant to Section 402 of the Job Creation and Worker Assistance Act of 2002, Pub. L. No. 107-147, § 402, 116 Stat. 21, 40.

201. *Gilutz*, 531 U.S. at 220.

202. See, e.g., *Coltec Indus., Inc. v. United States*, 62 Fed. Cl. 716, 756 (2004) (stating, "where a taxpayer has satisfied all statutory requirements established by Congress . . . , the use of the 'economic substance' doctrine to trump 'mere compliance with the Code' would violate the separation of powers"), *rev'd*, 454 F.3d 1340 (Fed. Cir. 2006); *Compaq Computer Corp. v. Comm'r*, 277 F.3d 778 (5th Cir. 2001); *IES Indus. Inc. v. United States*, 253 F.3d 350 (8th Cir. 2001).

dermined the common law economic substance doctrine's ability to target tax abuse.²⁰³

Congress's codification of the economic substance doctrine in Section 7701(o) has helped minimize some of the negative effects of this textualist trend. As described above, the literal language of Section 7701(o) imposes two requirements on every "relevant" transaction to which a Code section might otherwise apply: an economic effect requirement and a non-tax business purpose requirement.²⁰⁴ Thus, codification prevents textualist courts from claiming that the economic substance doctrine is not literally required by statute and therefore refusing to recognize the existence of the doctrine. Moreover, the statutory language of Section 7701(o) also makes it difficult for textualist judges to ignore the absence of a non-tax purpose or the absence of any economic effect in their tax abuse analysis as these requirements are literally required by Section 7701(o).

Despite the foregoing, codifying the economic substance doctrine does not completely prevent the textualist approach from undermining the government's fight against tax abuse. Although Congress has statutorily clarified when a transaction has economic substance, Congress has left the determination of when economic substance is "relevant" and should be applied to the courts. As one commentator correctly observes, "[T]hat leaves textualist courts hostile to purposive interpretation free to ignore the doctrine."²⁰⁵ Therefore, Congress may need to amend Section 7701(o) if textualist courts interpret Section 7701(o) in a manner that makes it not applicable to transactions that obtain tax benefits by satisfying the literal terms of the statute but circumvent the Code's purpose.

In the event that this situation arises, this Article proposes that Congress should expressly state in the statute that Section 7701(o) is relevant to transactions that contradict the purpose of the specific provision and provide a manner for making this determination. Currently, Congress has only indicated in the legislative history that the economic substance doctrine's relevance to a transaction depends on whether the transaction's tax benefits are consistent with the congressional purpose or plan that the tax benefits were designed to effectuate. But, as the Canadian

203. Although some of the decisions where courts have applied a textualist approach to narrowly interpret the economic substance doctrine have been overturned on appeal, these cases reveal the significant textualist focus of statutory interpretation in the United States and a weakening of the common law economic substance doctrine. See *Burke*, *supra* note 117, at 315 (describing how the Fourth Circuit's textualist approach in *Black & Decker Corp. v. United States*, 436 F.3d 431 (4th Cir. 2006), leads to a skewed interpretation of statutory provisions and may ultimately erode the economic substance doctrine); Galle, *supra* note 117, at 363 (arguing that the recent textualist approach threatens the viability of the economic substance doctrine); Madison, *supra* note 18, at 458 (suggesting the district court decision in *Coltec* potentially lays out a basis for refusing to apply the common law version of the economic substance doctrine); Ventry, *supra* note 17, at 1408 (noting that many observers believed the government losses indicated the "death knell of the economic substance doctrine").

204. I.R.C. § 7701(o) (Supp. 2010).

205. Galle, *supra* note 117, at 402.

experience with similar language has demonstrated, this amendment on its own may not completely save Section 7701(o) from potential emasculation.

Thus, when making this amendment, Congress should also specify that the congressional intent does not need to be expressly provided in the relevant provision but may be determined in light of the applicable statutory or regulatory framework. In other words, Congress should require courts to employ a purposive method of statutory interpretation with respect to tax abusive transactions. Congress should also include the manner for determining congressional intent to provide both the courts and taxpayers guidance in determining congressional intent when the statute is silent. By doing so, Congress would make Section 7701(o)'s application more uniform and predictable and less likely to deter legitimate transactions. Many commentators have discussed methods of incorporating a congressional intent inquiry into tax disputes that are worthy of congressional consideration but this is beyond the scope of this Article.²⁰⁶ For instance, Congress could provide a systemized framework for determining congressional intent.²⁰⁷ Alternatively, Congress could provide an angel list of tax-favored transactions that are exempt from Section 7701(o) because Congress intended for the tax benefits to be permitted despite any tax avoidance purpose.²⁰⁸

B. EMPHASIS ON ECONOMIC EFFECTS

In addition, U.S. courts' emphasis on the economic substance of a transaction when distinguishing between legitimate and abusive tax transactions will probably also strengthen Section 7701(o) as an anti-abuse measure. Unlike Canada, where the Canadian GAAR is silent about the economic substance factor and Canadian courts have refused to consider the economic effect of an arrangement, Section 7701(o) expressly requires U.S. courts to consider economic substance when distinguishing tax abuse from acceptable tax planning.²⁰⁹ By statutorily clarifying that a transaction must have economic effects other than federal tax benefits to be respected, Congress has precluded textualist courts from disregarding the relevance of economic substance as a factor in the tax abuse analysis.

206. See, e.g., Galle, *supra* note 117, at 380–87 (suggesting a method for Congress to enable courts to more easily identify what portions of their statutes are designed to incentivize taxpayers through subsidies and what portions are not); Lederman, *supra* note 26, at 392 (citing to other articles where commentators have addressed the mechanics of how to discern congressional intent with respect to a particular tax provision).

207. Galle, *supra* note 117, at 391–92 (suggesting that a clear statement of rules for intended tax benefits would be beneficial in determining congressional intent).

208. Lederman, *supra* note 26, at 443 (describing a framework that has been developed by other scholars that could include a nonexhaustive list of categories into which certain tax provisions fall, such as “(1) ‘provisions that are part of the general structure of the Code’; (2) two types of ‘giveaways’; and (3) two types of deviations from general principles to reflect administrative realities”).

209. See I.R.C. § 7701(o).

As the international experience illustrates, a court that takes economic substance into account in its tax abuse analysis is more likely to strike down an abusive transaction. Accordingly, unlike *The Queen v. Canada Trustco Mortgage Co.*, where the Canadian Supreme Court upheld a purported sale-leaseback transaction despite the lack of any meaningful economic effect,²¹⁰ in *Rice's Toyota World v. Commissioner*,²¹¹ the Fourth Circuit Court of Appeals characterized a similar transaction as abusive tax avoidance.²¹² The U.S. court reached this conclusion even though the relevant tax provisions did not specifically state that a transaction is required to have economic substance to be respected. In fact, the court disallowed the tax deductions relating to the sale-leaseback transaction because no reasonable possibility of profit existed, the purchased equipment was unnecessary and unrelated to the taxpayer's business, the transaction lacked tax-independent considerations, and the taxpayer had no economic risk of loss with respect to the property.²¹³

Moreover, Congress has further strengthened Section 7701(o)'s effectiveness as a tool for distinguishing between tax abuse and tax planning by eliminating any pre-tax profit potential requirement.²¹⁴ Because mere profit potential no longer necessitates a finding that a transaction has economic substance, Section 7701(o)'s statutory language has reduced the possibility of taxpayer manipulation and a finding of economic substance when the economic realities of the transaction are insignificant in relation to the tax benefits. Instead, Section 7701(o) requires taxpayers to prove that "the transaction changes in a meaningful way (apart from [f]ederal

210. [2005] 2 S.C.R. 601, paras. 73–78 (Can.).

211. 81 T.C. 184 (1983), *aff'd in part, rev'd in part*, 752 F.2d 89 (4th Cir. 1985).

212. *Id.* at 204. See *supra* Part IV.B. for a description of the Canadian Supreme Court's treatment of a similar purported sale-leaseback transaction.

Although the Fourth Circuit Court of Appeals used the common law economic substance doctrine to invalidate the transaction in *Rice's Toyota World*, the same result is likely to occur under Section 7701(o). See STAFF OF THE JOINT COMM. ON TAXATION, *supra* note 42, at 152 (stating that Section 7701(o) "clarifies" the application of the economic substance doctrine); Alison Bennett, *Corporate Taxes: IRS Analysis of Economic Substance Cases to Remain Unchanged Following Codification*, DAILY TAX REP., May 10, 2011, at G-7 (reporting that the IRS Associate Chief Counsel, William Alexander, stated that the IRS analysis of economic substance cases will not change as a result of codification of the doctrine).

213. *Rice's Toyota World*, 752 F.2d at 91–95. Cf. *Frank Lyon Co. v. United States*, 435 U.S. 561 (1978) (respecting a sale-leaseback transaction for tax purposes even though the transaction limited the taxpayer's economic return because the transaction involved independent parties, with bona fide negotiations, the taxpayer committed its own capital and was liable on the note for the property purchase, and the taxpayer incurred some economic risk with respect to the transaction).

214. Prior to codification, some courts required a transaction to have pre-tax profit potential to be respected under the economic substance doctrine. See, e.g., *Knetsch v. United States*, 364 U.S. 361, 365–66 (1960) (denying interest deductions arising from the taxpayer's transactions with an insurance company because the transactions had no potential for economic gain beyond a tax deduction); *Goldstein v. Comm'r*, 364 F.2d 734, 740 (2d Cir. 1966) (holding that the taxpayer entered into a leveraged purchase of U.S. bonds without any realistic expectation of pre-tax profit and solely to secure tax benefits in the form of an interest deduction that would offset the economic loss generated by the transaction and therefore denying the tax benefits).

income tax effects) the taxpayer's economic position."²¹⁵ A taxpayer can rely on a transaction's profit potential to prove the transaction had an economic effect, but, according to Section 7701(o), this factor can be taken into account only if the profit potential is substantial in relation to the tax benefits.²¹⁶ Thus, this statutory language prevents courts from incorrectly characterizing an abusive transaction as legitimate merely because it has nominal pre-tax profit.²¹⁷

C. CONSIDERATION OF SUBJECTIVE BUSINESS PURPOSE

On the other hand, Section 7701(o)'s focus on the taxpayer's subjective purpose for entering into a transaction potentially undermines the statute's ability to identify and counter abusive transactions. Because a taxpayer's subjective motivation is subject to manipulation, focusing on the taxpayer's subjective purpose for entering into a particular arrangement enables taxpayers to satisfy the non-tax purpose requirement by fabricating sufficient evidence of a significant non-tax purpose after the fact.²¹⁸ In addition, focusing on the taxpayer's subjective purpose also undermines Section 7701(o), because the taxpayer's reason for engaging in a transaction does not necessarily correspond to the congressional intent with respect to the provision generating the tax benefits. Therefore,

215. I.R.C. § 7701(o)(1)(A) (Supp. 2010).

216. *Id.* § 7701(o)(2)(A). There are still issues left to resolve with respect to this factor. Although the statute states that "the present value of the reasonably expected pre-tax profit from the transaction is substantial in relation to the present value of the expected net tax benefits" from the transaction, it does not clarify what "substantial" means for these purposes. *See id.* The statute also does not clarify what discount rate should be used in making this calculation. *See id.*

217. Congress likely clarified that courts can only consider profit potential as evidence of economic substance when the profit potential is substantial to reverse results in cases such as *Compaq Computer Corp. v. Comm'r*, 277 F.3d 778 (5th Cir. 2001). *See* McMahon, *supra* note 17, at 1727; Prebble, *supra* note 19, at 3. In *Compaq Computer*, the taxpayer entered into a dividend-stripping transaction that was carefully structured to generate tax benefits that would shield from taxation the taxpayer's capital gain on an unrelated investment. 277 F.3d at 779–80. To achieve these benefits, the taxpayer purchased approximately \$887 million of stock from a company that was about to issue a dividend. *Id.* at 780. Significantly, the taxpayer purchased this \$887 million of stock without any independent inquiry into the value of the stock. *Id.* at 779–80. Less than one day after purchase, the taxpayer received a gross dividend and sold the stock back to the seller for at an approximate \$19 million loss. *Id.* at 780. After taking into account the transaction costs, the transaction generated a pre-tax profit of approximately \$2 million, but this profit was nominal in comparison to the substantial capital loss and the \$887 million investment. *Id.* at 786. The \$2 million of profit was actually much smaller once the payment of foreign withholding taxes on the dividend was taken into account. *Id.* Nevertheless, the Fifth Circuit Court of Appeals found that this \$2 million of pre-tax profit potential generated by the dividend-stripping transaction indicated that the transactions at issue did not lack economic substance. *Id.*

218. For instance, a taxpayer recently attempted to fabricate evidence of a significant business purpose after the taxpayer had already entered into the transaction in *WFC Holdings Corp. v. United States*, Civ. No. 07-3320 (JRT/FLN), 2011 WL 4583817, at *33–36 (D. Minn. Sept. 30, 2011). Although the court in this case recognized that the business purposes was fabricated to conceal the true purpose of the transaction, it is likely that many situations exist where the taxpayer successfully generates evidence of a non-tax purpose that is accepted by the IRS or the court.

this Article proposes that Congress amend Section 7701(o) to require evidence that the arrangement's objective purpose is to defeat the intent and purpose of the Internal Revenue Code or any of its provisions before Section 7701(o) can strike down the transaction.

The results in several controversial cases would likely be different if the courts had focused on whether the arrangement's objective purpose was to defeat the intent and purposes of the Internal Revenue Code, rather than on the taxpayer's subjective intent. For instance, in *Frank Lyon Co. v. United States*, the taxpayer entered into a sale-leaseback transaction with a bank.²¹⁹ The bank wanted to build a new building but could not obtain conventional mortgage financing or regulatory approval to invest in the building.²²⁰ Therefore, the bank entered into a sale-leaseback transaction with the taxpayer where the taxpayer essentially financed the building of the bank and also obtained depreciation and interest deductions.²²¹ The U.S. Supreme Court held that the transaction was not abusive under the economic substance doctrine partly because a subjective business purpose to build a bank existed.²²² However, this subjective purpose should not have influenced the outcome of the case, because it is not indicative of which transactions Congress intended to generate depreciation and interest deductions.

On the other hand, if the objective evidence of the transaction's purpose had been considered, the court would have more likely have characterized the transaction as abusive. The objective evidence indicated that the primary purpose of the sale-leaseback transaction was to generate depreciation deductions and other income tax benefits for the taxpayer to incentivize the taxpayer to help the bank build a new building at a below-market rate of return.²²³ The taxpayer was more akin to a lender, who is not eligible for depreciation deductions, than the true economic owner of the building.²²⁴ Because Congress intended for depreciation deductions to be taken by owners of property and not lenders, the transaction likely circumvented congressional intent.²²⁵ Thus, the tax benefits should have been disallowed, notwithstanding the parties' subjective non-tax motives.

219. 435 U.S. 561, 564–65 (1978).

220. *Id.* at 563–64.

221. *Id.* at 564–65.

222. *Id.* at 583–84.

223. See Lederman, *supra* note 26, at 410–12. Specifically, to purchase the building, the taxpayer invested \$500,000 cash and took out a loan of approximately \$7 million. *Id.* at 409. Pursuant to the arrangement, the investment generated a below-market rate of return. *Id.* at 410. To incentivize the taxpayer to enter into the arrangement and to make the arrangement economically worthwhile, the transaction was structured so that the taxpayer could obtain the income tax benefits of ownership. *Id.* at 410–12.

224. *Id.* at 410. The evidence indicated that the taxpayer did not have any economic pre-tax profit potential, as a true owner should. Although the Supreme Court correctly concluded that the taxpayer had an economic risk of loss, this risk of loss was the same risk a lender would have had in this situation—the risk that the borrower would declare bankruptcy and the value of the asset would be less than the taxpayer's loan balance at that time. *Id.* at 411. Thus, this evidence further highlighted that the transaction purposefully treated the taxpayer as an owner rather than a lender to generate tax benefits.

225. See I.R.C. § 167 (2006 & Supp. 2010).

D. BURDEN OF PROOF

In the United States, the taxpayer, rather than the government, has the burden of proving that a transaction has a meaningful economic effect and a substantial non-tax purpose.²²⁶ Therefore, the United States has not adopted the Canadian approach of placing an oppressive burden on the government to prove the existence of an abusive transaction. The American approach helps improve the effectiveness of Section 7701(o) by enabling the IRS Commissioner to more easily apply Section 7701(o) to tax abusive transactions and counteract the detrimental effects of tax abuse.

However, placing the burden of proof on taxpayers creates a risk that the Commissioner will over-apply Section 7701(o) and is potentially detrimental to Section 7701(o)'s goals. This risk is especially significant now, because when Congress codified the economic substance doctrine it included a harsh new penalty provision to accompany it.²²⁷ The new penalty provision applies a strict liability penalty of 20% for disclosed transactions that lack economic substance or fail to meet any similar economic rule of law and a 40% understatement penalty for non-disclosed transactions that lack economic substance or fail to meet any similar economic rule of law.²²⁸ This means that no exceptions, including reasonable cause or good faith, are available to a taxpayer who engages in a transaction that is determined to lack economic substance.²²⁹ As a result, taxpayers are under a lot of pressure to satisfy their burden of proof.

Both Congress and the IRS have taken steps to minimize the risk of the Commissioner applying Section 7701(o) to legitimate tax planning transactions. Specifically, the Joint Committee on Taxation, in its report relating to Section 7701(o), specifies a non-exclusive list of basic business transactions to which Section 7701(o) should not apply.²³⁰ This language

226. See I.R.C. § 7701(o)(1)(A), (B) (Supp. 2010); *Coltec Indus., Inc. v. United States*, 454 F.3d 1340, 1355 (Fed. Cir. 2006) (“[W]hen the taxpayer claims a deduction, it is the taxpayer who bears the burden of proving that the transaction has economic substance.”).

227. See Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, § 1409(b), (c)(1), 124 Stat. 1029, 1068–69.

228. I.R.C. §§ 6662(a), (b)(6), (i)(I), 6664(c). This new penalty provision not only applies when the economic substance doctrine is involved, but also when any other “similar rule of law” applies. *Id.* § 6662(b)(6). It is unclear what other laws can trigger this strict liability penalty. Many scholars agree that this new penalty provision is objectionable on policy and other grounds and creates substantial vagueness and uncertainty in application. See, e.g., Kathleen D. Thomas, *The Case Against a Strict Liability Economic Substance Penalty*, 13 U. PA. J. BUS. L. 445, 490 (2011); VanderWolk, *supra* note 113, at 548, 552.

229. See I.R.C. § 6664(c).

230. STAFF OF THE JOINT COMM. ON TAXATION, *supra* note 42, at 152–53. The report also explains that: “[Section 7701(o)] is not intended to alter the tax treatment of certain basic business transactions that, under longstanding judicial and administrative practice are respected, merely because the choice between meaningful economic alternatives is largely or entirely based on comparative tax advantages.” *Id.* The immunized transactions include “(1) the choice between capitalizing a business enterprise with debt or equity; (2) a U.S. person’s choice between utilizing a foreign corporation or a domestic corporation to make a foreign investment; (3) the choice to enter a transaction or series of transactions that constitute a corporate organization or reorganization under subchapter C; and (4) the

helps ensure that Section 7701(o) will not be applied to alter the tax treatment of these non-abusive transactions.

The IRS has refused to promulgate an “angel list” of other immunized transactions.²³¹ However, the IRS has acted to mitigate the risk of over-applying Section 7701(o) and imposing the corresponding significant penalty on legitimate transactions by requiring all examiners and managers to obtain the approval of the appropriate Director of Field Operations within the IRS prior to applying Section 7701(o).²³² The IRS has also recently issued internal guidance to its examiners and managers that sets forth the procedures examiners and their managers must undertake before seeking approval to apply the economic substance doctrine.²³³ These measures may help prevent the Commissioner from substantially over-applying Section 7701(o) and achieve more uniformity at the agency level. However, this IRS guidance is not an official pronouncement of law, and cannot be used, cited, or relied upon as such.²³⁴ Thus, the extent to which the IRS and the courts will apply Section 7701(o) to transactions remains to be seen. If there is fear of undue uncertainty or excessive litigation, Congress should hone the application of Section 7701(o) by singling out certain objective factors and making them determinative of the matter as it has done in other laws. It should also promulgate a list of additional transactions that are immunized from Section 7701(o) and repeal the strict liability penalty because it exacerbates the uncertainty and unpredictability inherent in Section 7701(o).²³⁵

choice to utilize a related-party entity in a transaction, provided that the arm’s length standard of section 482 and other applicable concepts are satisfied.” *Id.* (footnotes omitted).

231. IRS Notice 2010-62, 2010-40 I.R.B. 411, 412 (Oct. 4, 2010).

232. IRS, LMSB-20-0910-024, CODIFICATION OF ECONOMIC SUBSTANCE DOCTRINE AND RELATED PENALTIES (Sept. 14, 2010), *available at* <http://www.irs.gov/businesses/article/0,,id=242254,00.html>.

233. IRS, LB&I-4-0711-015, GUIDANCE FOR EXAMINERS AND MANAGERS ON THE CODIFIED ECONOMIC SUBSTANCE DOCTRINE AND RELATED PENALTIES (July 15, 2011), *available at* <http://www.irs.gov/businesses/article/0,,id=242253,00.html>. Specifically, the Directive sets out four steps that an examiner must undertake prior to seeking approval to apply the doctrine. First, an examiner must evaluate specified facts and circumstances to determine whether the doctrine is not appropriate in that instance. *Id.* If the examiner believes factors indicate that the doctrine may be appropriate, then the examiner must continue to the second step and analyze whether the circumstances in the case show the application of the economic substance doctrine may be appropriate. *Id.* The Directive lists out certain facts and circumstances that the examiner should consider when performing this analysis. *Id.* Third, if after applying the guidance in the first two steps, the examiner believes the economic substance doctrine may apply, then the examiner must answer a series of inquiries that are set forth in the Directive. *Id.* Finally, if the examiner, in consultation with his manager and territory manager, determine that it is appropriate to seek approval of the Director of Field Operations, the Directive provides guidance on how to seek approval. *Id.*

234. *See id.*; IRS, LMSB-20-0910-024, *supra* note 232.

235. As other scholars have argued, the strict liability nature of the penalty is also unfair and disproportionate. *See, e.g.,* Lawrence M. Hill & Alexandra Minkovich, *Tax Policy Gone Wild: Harsh Penalties as Revenue Raisers*, 115 TAX NOTES 79, 80–82 (2007); Thomas, *supra* note 228, at 445 (arguing that “the new penalty adds significant and undue complexity to the current [penalty] regime”). For an in-depth discussion of the criticisms of the strict liability penalty, see Thomas, *supra* note 228.

E. IDENTIFYING THE RELEVANT SCHEME

In addition, Section 7701(o) contemplates that the economic substance doctrine can apply to disallow tax benefits arising from individual steps within a larger transaction.²³⁶ As the international experience indicates, inserting an element lacking in business purpose and economic effect into an overall legitimate transaction should not shield a transaction from a GAAR. Thus, courts that are willing to disaggregate transactions and apply Section 7701(o) to the specific transaction that generates the alleged tax benefit improve Section 7701(o)'s effectiveness at identifying and countering tax abuse in the United States.

Recent U.S. case law also demonstrates the importance of disaggregating abusive transactions from the overall arrangement when applying Section 7701(o). For instance, the Court of Appeals for the Tenth Circuit overruled the district court's decision in *Sala v. United States* that a taxpayer's \$60 million loss-generating foreign currency options transaction should be respected.²³⁷ The district court failed to separately consider the taxpayer's investment in a "Son of BOSS" tax shelter transaction,²³⁸ which was bundled with a legitimate investment activity.²³⁹ The "Son of BOSS" transaction enabled the taxpayer to artificially inflate his basis in a newly formed partnership and, therefore, generate substantial losses upon the subsequent pre-determined partnership liquidation and sale of the partnership assets.²⁴⁰

However, by focusing on the taxpayer's entire investment activities, rather than the individual activities, the district court incorrectly found the abusive transaction had economic effect and business purpose. The district court reached this conclusion despite the evidence that indicated the loss-generating investment activity was abusive. Specifically, the evidence showed that the taxpayer suffered no actual economic harm, the

236. The legislative history explains that the enactment of Section 7701(o) does not change the court's ability to aggregate, disaggregate, or otherwise re-characterize a transaction when applying the doctrine. Section 7701(o) merely reiterates the courts' ability under present law to bifurcate a transaction in which independent activities with business objectives are combined with an unrelated item having only tax-avoidance purpose in order to disallow the tax benefits arising from the tax-motivated item. STAFF OF THE JOINT COMM. ON TAXATION, *supra* note 42, at 153.

237. 613 F.3d 1249, 1250 (10th Cir. 2010).

238. A "Son of BOSS" transaction is a "sales option bond strategy" that has been identified as abusive by the IRS. See IRS Notice 2000-44, 2000-36 I.R.B. 254, 255. Under this type of transaction, a taxpayer generates losses by artificially inflating the basis of partnership interests. The taxpayer typically then sells the partnership interest (or an asset that derives its tax basis from the partnership interest) for a substantial loss, which the taxpayer uses to shelter income from other sources. Through this strategy, the taxpayer is able to generate a sizeable loss deduction without incurring a corresponding economic loss. See *id.*

239. *Sala v. United States*, 613 F.3d 1249, 1252 (10th Cir. 2010).

240. *Id.* In *Sala*, the taxpayer's wholly owned S-corporation contributed foreign currency options to a partnership. *Id.* at 1251. The taxpayer disregarded the value of the short options when calculating his basis in the partnership under a then-existing tax rule that disregarded short options as liabilities for purposes of establishing partnership basis. *Id.* at 1253. By increasing his basis in the partnership, the taxpayer was able to generate tax losses when the partnership liquidated after a few weeks and the taxpayer sold the partnership assets. *Id.* at 1252.

transaction was designed primarily to create a fictional loss, and the taxpayer did not contest that the tax loss was wholly artificial.²⁴¹ Even though the statute was silent about any economic substance requirement in this context, it is clear that Congress would not have intended for a taxpayer to benefit from a fictional loss at the expense of the government.²⁴² Thus, as both the international experience with GAARs and the U.S. tax abuse jurisprudence have shown, courts should focus on the particular transactions that generate the alleged tax benefit, not on secondary transactions that do not give rise to the tax benefits when applying a GAAR or a GAAR-like statute. Determining and evaluating the correct “transaction” is a critical aspect of effectively applying the economic substance doctrine to distinguish the abusive transactions from the legitimate ones.²⁴³

VI. CONCLUSION

Tax planning is an important part of our society. Although some tax benefits are specifically enacted to encourage taxpayers to engage in a particular behavior for policy or other reasons, not all tax minimizing transactions should be respected. There is a difference between legitimate tax planning and unacceptable tax abuse. The latter types of transactions are detrimental to the efficiency and fairness of our tax system and to our society as a whole. Thus, it is essential for governments to target tax abusive transactions and minimize these detrimental effects.

Countries worldwide often use similarly worded GAARs to address this common and costly tax abuse problem. The United States recently joined these countries by enacting a GAAR-like statute in Section 7701(o) of the Code. The international experience with GAARs shows that, if used correctly, Section 7701(o) can significantly help minimize the negative effects of tax abuse in the United States. By rejecting the *Duke of Westminster* principle and adopting other judicial approaches that have strengthened GAARs abroad, U.S. courts will likely increase Section 7701(o)’s strength as an anti-abuse weapon.

However, the United States judiciary has also taken several approaches that potentially render Section 7701(o) ineffective or create substantial uncertainty for taxpayers. Thus, Congress and the Treasury should take steps to remedy this situation and thereby bolster Section 7701(o)’s effectiveness and improve the economic efficiency and fairness of our tax system. Although Section 7701(o) is not a universal cure to the tax abuse problem in the United States, for Section 7701(o) to truly be an effective weapon in the fight against tax abuse, the judiciary, legislature, and tax

241. *Id.* at 1253–54.

242. The Tenth Circuit Court of Appeals has recognized that tax advantages must be linked to actual losses to be within Congress’s contemplation. *See id.* at 1253; *Keeler v. Comm’r*, 243 F.3d 1212, 1218 (10th Cir. 2001).

243. *Lederman, supra* note 26, at 417–18.

administration must all work together.²⁴⁴

244. See Evans, *supra* note 11, at 37.